TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, [redacted] 1914 1915

No. [redacted] 465 140

FRANK R. BRUSHABER, APPELLANT,

vs.

UNION PACIFIC RAILROAD COMPANY.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

FILED MAY 4, 1914.

(24,196)

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1913

No. 1015.

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vs.

UNION PACIFIC RAILROAD COMPANY.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MAY 7, 1914.

a The President of the United States of America to Union Pacific Railroad Company, Greeting:

[SEAL.]

You are hereby commanded to appear before the Judges of the District Court of the United States of America for the Southern District of New York, in the Second Circuit, to answer a bill of complaint exhibited against you in the said court in a suit in equity by Frank R. Brushaber, and to further do and receive what the said court shall have considered in this behalf; and this you are not to omit under the penalty on you of two hundred and fifty dollars ($250).

Witness, Honorable Charles M. Hough, Judge of the District Court of the United States for the Southern District of New York, at the City of New York, on the 13th day of March, in the year one thousand nine hundred and fourteen and of the Independence of the United States of America the one hundred and thirty- —.

—— ——, *Clerk.*

DAVIES, AUERBACH & CORNELL,
34 Nassau Street, Plaintiff's Sol'rs.

The defendant is required to file its answer or other defense in the above cause in the clerk's office of this court on or before the twentieth day after service hereof excluding the day of said service; otherwise the bill aforesaid may be taken pro confesso.

ALEX. GILCHRIST, JR., *Clerk.*

Filed Mar. 13, 1914.

b I hereby certify, that on the 13th day of March, 1914 at the City of New York, in my District, I served the within subpœna in Equity upon the within named defendant Union Pacific Railroad Company by exhibiting to Alexander Miller as Sec'y of said Co. at his office No. 135 Broadway, N. Y. City the within original and at the same time leaving with him a copy thereof.

WM. HENKEL,
United States Marshal, Southern District of New York.

Dated March 13th, 1914.

c District Court of the United States for the Southern District of New York.

In Equity.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant.

Bill of Complaint.

Davies, Auerbach & Cornell, Solicitors for Complainant, 34 Nassau Street, New York.
Julien T. Davies, Joseph S. Auerbach, Frederic J. Fuller, of Counsel.

Filed Mar. 13, 1914.

1 In the District Court of the United States for the Southern District of New York.

In Equity.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant.

To the Judges of the District Court of the United States for the Southern District of New York:

Frank R. Brushaber, a citizen of the State of New York and a resident of the Borough of Brooklyn, in the City of New York, brings this his bill against Union Pacific Railroad Company, a corporation and citizen of the State of Utah, having its executive office and a place of business in the Borough of Manhattan, in the City of New York, and the Southern District of New York, in his own behalf and on behalf of any and all of the stockholders of the defendant Union Pacific Railroad Company who may join in
2 the prosecution and contribute to the expenses of this suit. Thereupon your orator complains and says:

First. That your orator is a citizen of the State of New York and resides in the Borough of Brooklyn, in the City of New York, and has his principal place of business in the Borough of Manhattan, in the City of New York, and Southern District of New York.

Second. Your orator further shows that the defendant Union Pacific Railroad Company is, and at all the times hereinafter mentioned was, a corporation duly organized and existing under and by virtue of the Laws of the State of Utah, and a citizen of the State of Utah, and has its executive offices and a place of business at No. 165

Broadway, in the Borough of Manhattan, City of New York, and Southern District of New York.

Third. Your orator further shows that by the Laws of the State of Utah and the By-Laws of the said Company, the general control of the business and affairs of the said Company is entrusted to and conferred upon the directors thereof as a board, acting by the vote of the majority of the directors at a meeting thereof, and by an Executive Committee composed of six members of the Board who possess all the powers of the Board of Directors to manage and control all the business and affairs of the Company, when the Board is not in session.

Fourth. Your orator further shows that now and for some time prior to the filing of this bill, your orator is and was a stockholder of record of the defendant Union Pacific Railroad Company and a holder of five hundred shares of the common capital stock of said Company of the par value of one hundred dollars each.

3 Fifth. Your orator further shows that the defendant Union Pacific Railroad Company is, and at all times hereinafter mentioned was, duly authorized by an act of the Legislature of the State of Utah, approved January 22, 1897, under which Act said Railroad Company was organized July 1, 1897, to purchase or otherwise acquire, hold and obtain and operate railroads in various States of the United States, to mortgage the same by deeds of trust or mortgages and generally to purchase, take on lease or in exchange, hire or otherwise acquire any real or personal property, and any rights or privileges which its said board of directors may think necessary or convenient for the purposes of its business, to purchase and hold the stocks of other railroad corporations, and to operate on lease or by contract lines of railroad of other railroad corporations.

Sixth. That the said Union Pacific Railroad Company was duly authorized to issue shares of capital stock of the par value of $100 each in classes of preferred stock and common stock, and that said Company pursuant to such authority has issued and has now outstanding in the hands of the public shares of preferred stock to the amount in par value of $99,543,500 and shares of common stock to the amount in par value of $216,633,900. That dividends have been declared and paid upon the issued preferred stock and upon the issued common stock for many years last past.

Seventh. Your orator further shows that pursuant to the authority granted by its aforesaid act of incorporation, defendant Union Pacific Railroad Company heretofore and on or about the 1st day of July, 1897, made and executed to Bankers Trust Company of New York as Trustee, its First Mortgage to secure $100,000,000 of 50-Year Gold Four Per Cent Bonds due July 1, 1947, at the

4 Company's office in New York City, interest payable semi-annually on the first day of July and the first day of January. The said mortgage covers as a direct first lien various railroad lines and their appurtenances with a total mileage of 2,009.1 miles. The mortgage also covers either directly or by beneficial ownership, the land and land assets of the Union Pacific Railroad Company and of the Union Pacific Land Company. There

are now outstanding secured by the said mortgage $100,000,000 in par value of said bonds, to-wit, $87,975,500 of coupon bonds and $12,024,500 of registered bonds.

Each of the bonds issued and outstanding under the said mortgage is entitled to the benefit of a covenant and agreement on the part of the Union Pacific Railroad Company that the principal and interest on the said bond are payable without any deduction for any tax or taxes of the United States, or of any state or municipality thereof which the Railroad Company may be required to pay or retain therefrom under any present or future law.

That on or about the 1st day of June, 1908, the defendant Union Pacific Railroad Company made and executed to the Equitable Trust Company of New York as Trustee, its First Lien and Refunding Gold Mortgage, for the purpose of securing its 100-Year, First Lien and Refunding Gold 4's due June 1st, 2008. That the said mortgage was made a first lien upon various lines of railroad whose combined mileage amounts to 1,329.52 miles. That interest upon the said bonds is payable March 1st and September 1st in New York City. That there are now issued and outstanding of bonds secured by the said Mortgage in the hands of the public $31,585,000 coupon (Dollar) bonds, $7,093,000 Registered (Dollar) bonds, $25,922,280 (£5,344,800) coupon sterling bonds, and $485,000 (£100,000) registered sterling bonds, in all $65,085,280.

5 Each of the bonds issued under the aforesaid mortgage is entitled to the benefit of a covenant and agreement on the part of the said Railroad Company that both the principal and interest of the said bond shall be paid without deduction of any tax or taxes which the said Railroad Company may be required or permitted to pay thereon or to retain therefrom under any present or future law of the United States of America or of any state, county or municipality therein.

That on or about the 1st day of July, 1907, the said Union Pacific Railroad Company made and executed to Bankers Trust Company of New York as Trustee, its Twenty-Year Mortgage to secure its Twenty-Year Convertible Gold Four Per Cent bonds due July 1, 1927, of which the interest is payable on the 1st day of January and July at the Company's office in the City of New York. That there are outstanding secured by the said mortgage $36,338,000 coupon bonds, $397,500 of registered bonds, and $700 of scrip.

That each of the said bonds is entitled to the benefit of a covenant and agreement on the part of the said Railroad Company that the principal and interest of the said bond are payable without deduction for any tax or taxes which the said Company may be required to pay or retain therefrom under any present or future law of the United States or of any state, territory, county, or municipality therein.

Eighth. Your orator further avers that by Paragraph A, Subdivision 1, of Section II of an Act of the First Session of the Sixty-third Congress, entitled "An Act to reduce tariff duties and to provide a revenue for the Government and other purposes," which

Act became a law October 3, 1913, and which is popularly known as the Tariff Act, it is provided that there shall be levied,
6 assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to any citizen of the United States, whether residing at home or abroad, and to every person residing in the United States though not a citizen thereof, a tax of one per centum upon such income except as provided in said act, and that a like tax shall be assessed, levied, collected and paid annually upon the entire net income from all property owned and of every business, trade or profession carried on in the United States by persons residing elsewhere.

That it is further provided by said Paragraph A, Subdivision 2, of Section II of the said Act, that in addition to the said one per centum tax, which is referred to in the said Act and will be referred to herein as the "Normal Income Tax," there shall be levied, assessed and collected annually upon the net income of every individual an additional income tax referred to in the said Act and herein referred to as the "Additional Tax," of one per centum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000, two per centum upon the amount by which the total net income exceeds $50,000 and does not exceed $75,000, three per centum on the amount by which the total net income exceeds $75,000 and does not exceed $100,000, four per centum on the amount by which the total net income exceeds $100,000 and does not exceed $250,000, five per centum upon the amount by which the total net income exceeds $250,000 and does not exceed $500,000, and six per centum upon the amount by which the total net income exceeds $500,000. It is further provided by said Subdivision 2 that all the provisions of said Section II relating to individuals chargeable with the normal income tax so far as they are applicable and not inconsistent with said Subdivision 2, shall apply to the levy assessment and collection of the additional tax. It is further
7 provided by said Subdivision 2 therein that every person subject to the additional tax shall make a personal return of his total net income from all sources, corporate or otherwise, for the preceding calendar year, under rules and regulations to be prescribed by the Commissioner of Internal Revenue, and approved by the Secretary of the Treasury. It is further provided by said Subdivision 2 that for the purpose of this additional tax the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits if divided or distributed, whether divided or distributed or not, of all corporations, joint stock companies or associations however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed, and the fact that any such corporation, joint stock company or association is a mere holding Company or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business shall be prima facie evidence of a fraudulent purpose to escape such

tax, but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business.

It is further provided by Paragraph B of said Section II of said Act that subject only to such exemptions and deductions as are thereafter in the Act allowed the net income of a taxable person shall include gains, profits and income derived from salaries, wages or compensation for personal services, of whatever kind and
8 in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise or descent.

It is further provided in said Paragraph B that in computing taxable income for the purpose of the normal tax, there shall be allowed as deductions the following items with others: First, the necessary expenses actually paid in carrying on any business, not including personal, living or family expenses. Seventh, the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association or insurance company which is taxable upon its net income as provided in said Act; Eighth, the amount of income the tax upon which has been paid or withheld for payment at the source of the income as provided by Section II.

It is further provided by said Paragraph B, that in computing net income under Section II, there shall be excluded the interest upon the obligations of a State or any political subdivision thereof and upon the obligations of the United States or its possessions and the compensation of all officers or employees of a State or any political subdivision thereof except when paid by the United States Government.

That it is provided by Paragraph C of said Section II of the said Act that there shall be deducted from the amount of the net income of each of said persons, ascertained as provided therein, the sum of $3,000, plus $1,000 additional if the person making the return be a married man with a wife living with him,
9 or plus the sum of $1,000 additional if the person making the return be a married woman with a husband living with her; but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife, provided that only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together.

That it is further provided by Paragraph D of said Section II of the said Act that the said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December 31st; provided, however, that for the year ending December 31, 1913, said tax shall

be computed on the net income accruing from March 1st to December 31st, 1913, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions provided for in said Act, and that on or before the first day of March, 1914, and the first day of March in each year thereafter, a true and accurate return under oath or affirmation of the person making it shall be made by each taxable person, except as thereafter provided in said Section, to the collector of internal revenue for the district of residence or place of business of the taxpayer, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources, and from the total thereof deducting the aggregate items or expenses and allowance authorized by the Act, and that all fiduciaries shall make and render a like return of the income of the person for whom they act.

It is further provided that all fiduciaries and other persons and corporations having the control, receipt, disposal or payment of fixed or determinable annual or periodical gains, profits and in-
10 come of another person subject to tax shall, in behalf of such person, deduct and withhold from the payment an amount equivalent to the normal income tax thereon and make and render a return separate and distinct of the portion of the income of each person from which the normal income tax has been thus withheld, containing the name and address of such person or stating that the name and address, or address as the case may be are unknown, but the normal income tax is not required to be withheld at the source prior to November 1st, 1913, and no return of income not exceeding $3,000 is required, and members of partnerships are liable only in their individual capacity for their shares of partnership profits, and persons liable for normal tax only, on their own account or in behalf of another, are not required to make returns of income derived from dividends on the capital stock or from the net earnings of corporations and companies taxable on their net income.

It is further provided by said Paragraph D that if the collector or deputy collector has reason to believe that the amount of any income returned is understated he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated he may increase the same accordingly.

It is further provided in Paragraph E of said Section II of the said Act that all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the 30th day of June; and to any sum or sums due and unpaid after the 30th day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the
11 sum of 5 per centum on the amount of tax unpaid, and interest at the rate of 1 per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

It is further provided by said Paragraph E that all persons, firms, companies and corporations, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, employees and other persons having the control, receipt, custody, disposal or payment of the interest or other fixed or determinable annual gains, profits and income of another person exceeding $3,000 for any taxable year, other than dividends on capital stock or from the net earnings of corporations, and joint stock companies or associations subject to like tax, who are required to make and render a return in behalf of another, are thereby authorized and required to deduct and withhold from such annual gains, profits and income such sum as will be sufficient to pay the normal tax imposed thereon by the Act, and shall pay the tax to the officer of the United States Government authorized to receive the same; and they are each thereby made personally liable for such tax.

It is further provided by said Paragraph E that in all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source, as aforesaid, such person shall not receiv the benefit of the deduction and exemption allowed in Paragrap C aforesaid, except by an application for the refund of the tax, unless he shall not less than thirty days prior to the day on which the return of his income is due file with the person who is required to withhold and pay tax for him a signed notice in writing claiming the benefit of such exemption, and thereupon no tax shall be withheld upon the amount of such exemption.

12 It is further provided in said Paragraph E that the amount of the normal tax by said Act imposed shall be deducted and withheld from fixed and determinable annual gains, profits and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint stock companies or associations, whether payable annually or at shorter or longer periods, although such interest does not amount to $3,000, subject to the provisions of said Section II requiring the tax to be withheld at the source and deducted from annual income and paid to the Government, and likewise the amount of such tax shall be deducted and withheld from coupons, checks or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations (not payable in the United States); and also from coupons, checks or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations and insurance companies engaged in business in foreign countries; and the tax in each case shall be withheld and deducted for and in behalf of any person subject to the tax although such interest, dividends or other compensation does not exceed $3,000 by any banker or person who shall sell or otherwise realize coupons, checks or bills of exchange drawn or made in payment of any such interest or dividend (not payable in the United States), and any person who shall obtain payment (not in the United States) in behalf of another of such dividends and interests by means of coupons, checks or bills of exchange and also any dealer in such coupons who shall purchase the same

for any such dividends or interest (not payable in the United States) otherwise than from a banker or another dealer in such coupons, but in each case the benefit of the exemption and deduction
13 of $3,000 may be had by complying with the provisions of the said Paragraph.

It is further provided in said Paragraph E that nothing in the said Section II shall be construed to release a taxable person from liability for income tax nor shall any contract entered into after the Act takes effect be valid in regard to any Federal income tax imposed upon a person liable to such payment.

Paragraph F of said Section II of the said Act provides that if any person, corporation, joint stock company, association or insurance company liable to make the return or pay the tax aforesaid shall refuse or neglect to make a return at the time or times in said Section specified in each year, such person shall be liable to a penalty of not less than $20 nor more than $1,000.

Paragraph G of the said Section II of the said Act provides that the normal tax by said Section imposed upon individuals likewise shall be levied, assessed and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships, but if organized, authorized or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year. It is provided, however, that nothing in said Section II shall apply to labor, agricultural or horticultural organizations or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders or associations operating under the lodge system, or for the exclusive benefit of the members of a fraternity itself operating under the lodge sys-
14 tem and providing for the payment of life, sick, accident and other benefits to the members of such societies, orders or associations and dependents of such members, nor to domestic building and loan associations, nor to cemetery companies, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, nor to business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit but operated exclusively for the promotion of social welfare; provided further, that there shall not be taxed under said Section II any income, derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State, Territory or the District of Columbia.

It is further provided by Paragraph I of said Section II of the

said Act that in case of the refusal or neglect of any person, corporation, company, or association, except in cases of sickness or absence, to make a list or return or to verify the same as therein provided, the Commissioner of Internal Revenue shall add 50 per centum to the tax imposed by the said Act.

Ninth. Your orator avers that the defendant Union Pacific Railroad Company comes within the terms and purview of said Act and that compliance with the provisions of said Act requires said Company to make the returns provided for therein, and to pay said normal tax of one per cent upon its net income, and re-
15 quires the said Company to deduct and withhold the normal income tax of one per cent upon all coupons and interest upon its aforesaid issues of bonds heretofore paid and hereafter to be paid to individuals who may be the holders and owners of said coupons or entitled to said interest, who may not have filed with defendant notice of claim to the exemption of $3,000 or $4,000, as the case may be, and requires the said Company to pay the said tax of individuals so deducted and withheld.

Tenth. Your orator further avers that he is informed and believes that the said defendant Company and its Directors controlling its affairs intend voluntarily in the future, from year to year, to comply with the said provisions of the said Act with respect to making returns of net income and paying taxes imposed upon the net income of the said defendant, with respect to deducting and withholding the normal tax upon coupons and interest paid to individuals who are holders thereof or entitled thereto, and with respect to making returns of the taxes so deducted and withheld and paying said taxes, and that the said defendant either is about to make or has made a return of and with respect to the net income of said Company for the ten months of the year 1913 from March 1, 1913, to January 1, 1914, pursuant to said Act, and to pay such tax upon its net income as may be imposed thereon by the Commissioner of Internal Revenue in accordance with said Act, and that the tax on such net income will greatly exceed the sum of $3,000, and will be greater than the sum of $300,000, and is about to make a return, or has made a return, of and with respect to the amounts of the normal income tax heretofore deducted and withheld by the defendant upon coupons and in-
terest heretofore paid to the individuals entitled thereto who
16 have not claimed the exemption aforesaid of $3,000 or $4,000, and to pay over said normal income taxes so deducted and withheld to the Collector of Internal Revenue, and that the said defendant intends from time to time hereafter to make further returns and to pay further taxes upon its net income and will make further returns with respect to normal income taxes that it may have deducted and withheld with respect to coupons and interest due individuals, and will pay such taxes in pursuance of said Section II of said Act; and your orator is informed and believes that if this Court shall not grant to your orator the relief hereinafter prayed this defendant will, on or before the 30th day of June, 1914, pay such income tax as may be assessed against it for the said ten

months of the year 1913, from March 1, 1913, to January 1, 1914, in accordance with said Act, and will on or before the 30th day of June, 1914, pay over said normal income tax of one per cent deducted and withheld upon coupons and interest paid to individuals entitled thereto who have not claimed the exemption aforesaid of $3,000 or $4,000 and will in ensuing years make such returns and deduct and withhold and pay such taxes as the provisions of said Act purport to require.

Eleventh. Your orator further avers that so much of the provisions of the said Section II of the said Act of October 3, 1913, as seek to impose a tax of one per centum upon any net income of individuals or corporations and of the defendant received and collected prior to the third day of October, 1913, are unconstitutional and void, for the reason that the said Act did not become a law until October 3, 1913, and could not lawfully affect any receipts of the defendant before that date, because such receipts prior to October 3, 1913, had become property and capital of said defendant and had ceased to be income.

17 That said provisions of the said Act in seeking to impose a tax upon any so-called "net income" of the defendant received and collected between March 1, 1913, and October 3, 1913, which in reality was capital and real and personal property of the defendant upon October 3, 1913, when said Act became a law, are unconstitutional and void, for the reasons and in the respects hereinafter stated, to-wit:

(*a*) That such provisions are repugnant to and in conflict with the Third Clause of the Second Section of Article One of the Constitution of the United States, in that while such tax purports to be and is designated as a tax upon net income it is in truth and in fact a tax upon the real and personal property represented by and in which were invested the net receipts of the defendant between March 1, 1913, and October 3, 1913, and is a direct tax within the meaning of the aforesaid Clause and is not, as provided in said Clause, apportioned among the several States in the manner prescribed in said Clause and in Article XIV of the Amendments to the said Constitution and such provisions are, therefore, unconstitutional and void.

(*b*) That the provisions aforesaid are repugnant to and in conflict with the Fourth Clause of the Ninth Section of Article One of the Constitution of the United States, in that the tax sought to be imposed by such provisions, although such tax purports to be on the net income of the corporation between March 1, 1913, and October 3, 1913, is in truth and in fact a tax upon the real and personal property represented by and in which the corporation had invested its net income received between said March 1st, 1913, and October 3,

18 1913, and is a direct tax within the meaning of such clause, and is not laid in proportion to the census or enumeration directed to be taken in the Constitution, as in such case made and provided, and such provisions are therefore unconstitutional and void.

Twelfth. Your orator further avers that the taxes imposed by said Section II of the Act of October 3, 1913, are unconstitutional and

void in that there are specifically exempted from the imposition of such tax labor, agricultural or horticultural organizations, mutual savings banks not having a capital stock represented by shares, fraternal beneficiary societies, orders or associations, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident and other benefits to the members of such societies, orders or associations and dependents of such members, domestic building and loan associations, cemetery companies organized and operated exclusively for the mutual benefit of their members, corporations or associations organized and operated exclusively for religious, charitable, scientific or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, business leagues, chambers of commerce or boards of trade not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual, civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, and income derived from any public utility accruing to any State, territory, or the District of Columbia, or any political subdivision thereof, and that the restricted powers of the
19 Federal Government do not permit of the exemption from the operation of an income tax of any one of the aforesaid subjects. That many of the corporations so exempted from the operation of the provisions of the said Act of October 3, 1913, are direct competitors of corporations and individuals subject by its terms to the provisions of the said Act and of this defendant in some of their and its business activities, especially in the investment of moneys and the receipt of income and interest therefrom, and that the said provisions of the said Act fail to impose equality of burden among direct competitors and violate the rule of uniformity and equality and involve unreasonable and arbitrary discrimination and classification, and for those reasons among others are unconstitutional and void and in conflict with the provisions of Article V of the Amendments to the Constitution of the United States and involve the taking of property without due process of law and the taking of property for public use without compensation. That the number of exempted corporations and the amount of their incomes exempted from the operation of the Act is so great as materially to increase the burdens of the Act upon the corporations and individuals remaining subject thereto.

Thirteenth. Your orator further avers that the taxes proposed to be assessed and collected and the provisions of said Section II of the said Act of October 3, 1913, providing for the ascertainment, assessment, levy and collection of such taxes are unconstitutional and void, in that they are inconsistent with and violate the provisions of the said Fifth Amendment to the Constitution of the United States, that property shall not be taken without due process of law and that private property shall not be taken for public use without compensation. That said provisions of said Act, while purporting

to have been enacted by the exercise of the taxing power
20 of Congress, in fact were not the result of a lawful exercise of such power, for the reason that said provisions involve discriminations and classifications of the persons and corporations and of the incomes of persons and corporations within the scope of the said provisions that do not rest upon differences which bear a reasonable and just relation to the act in respect to which the classification is proposed, but are made arbitrarily and without any such basis. That such classifications are arbitrary and not reasonable. That distinctions are made in the burdens imposed by said provisions because of wealth, and that said provisions so far as they make such distinctions involve classification that is arbitrary and not reasonable, and constitute class legislation, and are therefore unconstitutional and in contravention of said Fifth Amendment of the said Constitution. That some of the said numerous unconstitutional, arbitrary and unreasonable classifications for purposes of taxation contained in the said provisions of the said Act are as follows:

(1) The provisions of the said Act provide for the taxation only of incomes of individuals for the year 1913 exceeding $2,500 in amount, and in the case of the aggregate incomes of a husband and wife living together of the amount of $3,333.33, and for subsequent years thereafter provide for taxation only of incomes over $3,000 per annum or $4,000 per annum in the case of a husband and wife living together as their aggregate income.

Your orator avers upon information and belief that the population of the United States on October 3, 1913, was over 90,000,000 persons; that the number of persons who would be liable by reason of possession of incomes to pay tax under the provisions of the said Act is about 499,000.

21 Your orator avers that the said exemption of $3,000 or $4,000, as the case may be, is unreasonable and arbitrary and involves a discrimination and classification founded upon wealth and is unreasonable and arbitrary between those who possess incomes under $3,000 or $4,000, as the case may be, and those possessing incomes above those amounts, and that the provisions of the said Act result in the burden imposed thereby falling upon slightly more than one-half of one per centum of the entire population of the country.

Your orator avers that the said exemptions of $3,000 or $4,000 as the case may be, are exemptions of amounts greatly larger than amounts the tax upon which would about equal the expense of collecting said tax.

Your orator avers that under wise and constitutional legislation, every citizen should contribute his proportion, however small, to the support of the Government; that the only constitutional measure of exemption from taxation is the rule that the expense of collecting the tax upon the amount of the exemption should about equal the amount of the tax thereon, and that an exemption from taxation of an amount as to which the expense of collection of its tax would substantially be less than the amount of said tax involves the taking

of property without due process of law of those who are obliged to pay a tax under an Act containing such an unjust exemption, and of the taking of their property for public use without compensation.

(2) The provisions of the said Act and the decisions of the Treasury Department made in pursuance of the power conferred by said Act in permitting an exemption for the tax year 1913 of
22 $2,500 or $3,333.33, as the case may be, and for other years of $3,000 or $4,000, as the case may be, with respect to the normal tax upon individuals deny such an exemption with respect to the tax of one per centum upon the net income of this defendant and of other corporations. Discrimination and classification are thus made between individuals and corporations with respect to the said exemptions. Such discrimination and classification do not rest upon any difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and are arbitrary and not reasonable and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(3) By the provisions of the said Act the defendant and other corporations indebted upon coupon or registered bonds are required to deduct and withhold at the source one per cent. upon the coupons and registered interest upon said bonds and to make returns to and to pay the taxes so withheld to a Collector of Internal Revenue on the 30th of June of each year. Where the corporation has assumed and agreed to pay the tax directed by the Act to be withheld, compliance with the statute requires it to pay the tax, in cases where the creditor, although entitled to an exemption, fails to file claim to exemption with the debtor corporation, which has no means of either compelling the debtor to claim such an exemption or of ascertaining whether or not in fact the debtor is entitled thereto. In cases of individual holders of coupons or those entitled to registered interest whose entire net income amounts to less than $3,000 the
23 payment of the tax is nevertheless required from the corporation debtor, although it is not justly due to the Government and such payment results in an unnecessary loss to the corporation and to the receipt by the Government of moneys to which it is not entitled. Such must be the inevitable operation of the Act in many cases, without redress to the corporation which has assumed the payment of the tax upon its coupons and registered interest and which pays the tax on account of a creditor against whom by reason of his having an income of less than $3,000 the Government has no lawful claim, and with respect to whom the debtor corporation cannot ascertain that his entire income is less than $3,000. The Act provides no means or machinery by which it can be ascertained by the corporation whether or not an individual entitled to collect coupons or registered interest from a corporation is entitled to an exemption of $3,000 or less on income of less than $3,000 upon which an application to the Government to refund taxes not lawfully due could be founded. Such operation of the Act results in a discrimination between and a classification of those corporations which have assumed to pay the tax upon their coupons and regis-

tered interest (the Act lacking provisions that grant them protection and redress), and such corporations as have not assumed to pay the tax upon their coupons and registered interest. Both classes of corporations are obliged to undertake great labor and go to great expense in connection with the payment of their coupons and registered interest, the filing of claims for exemption, deduction and withholding and payment of taxes thereon, acting as the col-
24 lecting agents of the Government, correspondence with holders of coupons and creditors, and many other matters connected with the subject, although corporations which have not assumed payments of taxes are not exposed to positive loss of taxes withheld and paid, as the loss occasioned by the payment of such taxes in the case of creditors having incomes of less than $3,000 would fall upon such creditors and not upon the corporations. Your orator avers, on information and belief, that the annual additional expenses of the defendant corporation in connection with the performance of its duties of collection of income tax at the source which involves hiring of additional clerks, opening and keeping additional books of record, the making out of many documents and returns, additional bookkeeping, labor of various sorts, correspondence, and other matters, will amount to the sum of at least between five and ten thousand dollars. That the purpose of the aforesaid requirements is to assist the Government of the United States in collecting the said Income Tax, and to give to it information with respect to individuals liable to pay said tax. That compliance with such requirements imposes an additional burden upon this defendant and other corporations over and above the amount of any tax that can be levied and assessed upon them under the terms of said Act, and that the imposition of such a burden is contrary to and violative of the Fifth Amendment to the Constitution of the United States and involves taking of property without due process of law and the taking of private property for public use without compensation. That corporations which are not indebted are not subjected to any such burden.

25 The provisions of the said Act relative to collection at the source create a further discrimination between and a classification of corporations which are indebted upon coupons and registered interest and those corporations which are not so indebted. Your orator avers, upon information and belief, that there are many thousand corporations in the United States which are not indebted upon coupon bonds or upon registered bonds bearing interest, and which are therefore under no obligation or duty to collect taxes upon income of individuals at the source and which are freed from the burdens and expense and labor imposed upon corporations which have outstanding coupon and registered bonds held by individuals. The discriminations and classifications aforesaid are not based upon any differences which bear a reasonable and just relation to the act in respect to which the classification is proposed, and are arbitrary and are not reasonable, and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(4) The taxes imposed by the said provisions of said Act of October 3, 1913, and the provisions of the said Act, are unconstitutional and void, and unreasonably and unlawfully classify domestic corporations for the purposes of the tax by providing how said net income may be arrived at from the said gross income of such corporations received from all sources. It is prescribed that there is to be deducted the amount of interest accrued and paid within the year on the indebtedness of such a corporation to an amount of such indebtedness not exceeding one-half of the sum of its interest
26 bearing indebtedness and its paid up capital stock outstanding at the close of the year, or, if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year, whereby all interest paid by the defendant and other domestic corporations, upon indebtedness that is more than one-half of the total indebtedness of any such corporation and its paid up capital stock is not allowed as a deduction to such corporation, whereas corporations not having indebtedness greater than one-half of their indebtedness and their paid up capital stock are allowed a deduction equal to the entire amount of their indebtedness, with the result that corporations being indebted over and above the amount of one-half of their indebtedness and their paid up capital stock are required to pay such tax upon their net incomes at a higher rate than such other corporations. That in case of a corporation indebted for more than the amount of its capital stock, the result of the operation of the Act is to tax as income of the corporation, monies received and disbursed, not as earnings, but as interest payments to its creditors, and which in the hands of its creditors are again taxed for the same year as income of the creditors, and this is the case even if such corporation in fact has no net income.

The discrimination and classification aforesaid are arbitrary and are not reasonable and are founded upon a difference that does not bear a reasonable and just relation to the act in respect to which the classification is proposed and are not founded upon a difference that the restricted powers of the Federal Government permit to
27 be the basis of classification, and the said provisions of the Act of October 3, 1913, violate the Fifth Amendment to the Constitution of the United States and involve taking property without due process of law and the taking of private property for public use without compensation.

(5) The aforesaid tax and the aforesaid provisions of said Act of October 3, 1913, are unconstitutional and void, in that while it is provided that domestic corporations generally are to be allowed a deduction in computing their net income of only the interest paid on so much of the corporate indebtedness as does not exceed the amount of one-half of the said indebtedness and the paid up capital stock of such corporations, yet in computing the net income in the case of a bank, banking association, loan or trust company interest paid within the year on deposits or on moneys received for investment and secured by interest bearing certificates of indebtedness

issued by such bank, banking association, loan or trust company is so allowed to be deducted, notwithstanding said deposits constitute part of the indebtedness of such company, and a discrimination between and a classification of banks, banking associations and trust companies and domestic corporations other than banks, banking associations, loan or trust companies are thereby created. That such discrimination and classification are arbitrary and not reasonable and are founded upon a difference that does not bear a reasonable and just relation to the act in respect to which the classification is proposed, and the said provisions of the Act of October 3, 1913, violate the Fifth Amendment of the Constitution of the United States and involve taking property without due process of law and the taking of private property for public use without com-
28 pensation, and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(6) The provisions of the said Act and the decisions of the Treasury Department made in pursuance of the power conferred by the said Act do not require individuals to make return of and pay the normal tax upon the amount received by them as dividends upon the stock or from the net earnings of any corporation, joint stock company or association and insurance company which is taxable upon its net income, and do require corporations, joint stock companies or associations and insurance companies to make return of and pay the tax of one per centum upon the amount received by them as such dividends. The defendant owns stocks of other corporations to the amount of several millions of dollars in value and is directly affected by said provisions, and during the year 1913, received large sums as dividends upon said stocks. Discrimination and classification are thus made between individuals and such corporations, joint stock companies or associations and insurance companies, and a less burden of taxation is laid upon such individuals than upon the other subjects of the Act above named, thus discriminated against. This discrimination is intended to have, and in fact has the effect of penalizing holding companies although lawfully holding stock of other corporations by authority of the statutes of the State of their incorporation. Such discrimination and classification are not founded upon a difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and are arbitrary and not reasonable, and are not founded upon a difference that the restricted powers of
29 the Federal Government permit to be the basis of classification.

(7) The provisions of the said Act providing for additional or progressive taxes, upon individuals by which net incomes exceeding $20,000 and not exceeding $50,000 are taxed one per centum additional, and by which net incomes exceeding $50,000 and not exceeding $75,000 are taxed 2 per centum additional and incomes exceeding $75,000 and not exceeding $100,000 are taxed 3 per centum additional, and incomes exceeding $100,000 and not exceeding $250,000 are taxed 4 per centum additional, and incomes

exceeding $250,000 and not exceeding $500,000 are taxed 5 per centum additional, and incomes exceeding $500,000 are taxed 6 per centum additional, result in establishing different rates of taxation upon the net incomes of those possessing different amounts of net income. Your orator further avers upon information and belief that the population of the United States on October 3, 1913, was over 90,000,000 persons; that the number of persons who would be liable by reason of the possession of incomes to pay tax under the provisions of said Act is about 499,000, of which about 456,500 persons possess taxable net incomes less than $20,000 in amount and about 42,500 persons possess taxable incomes over $20,000 in amount; that the income and revenue for the first year under said Act of October 3, 1913, will be about $82,673,000, of which about $13,000,770, or 16½ per cent of the total amount estimated to be collected, will be paid by the said 456,500 taxpayers, while about $68,000,903, or 83½ per cent of the total amount estimated to be collected by the said Act, will be paid by the said 42,500 persons.

30 By these provisions of the act discrimination and classification are made solely upon the basis of wealth. Such discrimination and classification are arbitrary and not reasonable, and are class legislation and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(8) The provisions of the said Act hereinbefore set forth require a deduction at the source, of the tax by corporations and by fiduciaries and by others, upon coupons and interest paid to individuals whereby the owner of such income is deprived of the use and benefit of the moneys so withheld during the period of time between the date of the withholding and the date either of the assessment of said tax against him or the payment of said tax by him. Many of those who are subject to the provisions of the said Act were during the year 1913 and will be in future years in receipt of incomes taxable under the provisions of the said Act, no part of which is or will be withheld at the source, who have not been and will not be deprived by the operation of the Act of the use and benefit of any part of their income during the dates aforesaid. The provisions of the said Act discriminate between and classify into two distinct classes owners of taxable income part or the whole of which is withheld at the source, and owners of taxable income no part of which is withheld at the source. Such discrimination and classification are not founded upon a difference which bears a reasonable and just relation to the Act in respect to which the classification is proposed and are arbitrary and not reasonable.

(9) The provisions of the said Act while permitting an exemption in the case of individuals for the tax year 1913 of $2,500

31 or $3,333.33, as the case may be, and for other years of $3,000 or $4,000, as the case may be, with respect to the normal tax, deny such an exemption with respect to the additional tax; that is to say, that while the owner of taxable income to the amount of $20,000 or less is allowed the exemptions aforesaid, the owner of taxable income above $20,000 as to which an additional

tax is imposed is not allowed any such exemption with respect to the additional tax. Discrimination and classification are thus made between owners of taxable incomes of $20,000 and less and owners of taxable incomes above $20,000. Such discrimination and classification are founded upon wealth alone as a basis and are unreasonable and arbitrary, and are class legislation, and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(10) The provisions of the said Act which deny in the assessment of the said additional tax upon individuals the deduction from gross income of income derived from dividends on stock or from the net earnings of corporations, joint stock companies, associations or insurance companies, subject to like tax, discriminate between and classify into two classes those who possess taxable incomes of $20,000 or less and those who possess taxable incomes exceeding $20,000. That such distinction and classification are based solely upon wealth and are arbitrary and not reasonable and are class legislation, and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

32 (11) The provisions of the said Act and the decisions of the Treasury Department made in pursuance of the power conferred by said Act provide for the taxation and the inclusion in the return of the individual taxpayer, under the designation of income on which at the source, tax has not been deducted and withheld, of income, upon which the payment of the tax by agreement has been assumed, withheld and set aside for purposes of payment to the Government by debtors from whom such income is derived and paid in compliance with such an agreement, without diminution by the said debtors to the individuals entitled to such income. Compliance with such requirement will necessarily result in the tax being paid twice—once by the debtor who has assumed to pay the tax, and who in legal effect has deducted and withheld the tax at the source, and is liable to pay it to the Federal Government, notwithstanding that in compliance with his covenant he has also included the amount thereof in his payment to the creditor, and secondly by the creditor and individual taxpayer in the assessment which will inevitably be made upon his return. A failure to make such payment by the creditor and income taxpayer would expose him to the punishments and penalties provided in the said Act. Having made such payment of a tax upon income which is also paid by the debtor, who has deducted and withheld the tax at the source, the taxpayer can be reimbursed only by going to the expense and labor of an application for a refund, with the loss of the use and the benefit of the money that he is entitled to have refunded, during the interval of time between his payment thereof and the success of his application. Such provisions
33 of the said Act and said decisions create a discrimination and classification between those whose tax has been deducted and withheld at the source by debtors from whom income is derived, who have assumed the payment of the tax, and owners of

taxable income on which the tax has been deducted and withheld at the source by debtors who have not assumed the payment of the tax, and create an onerous, unnecessary and unjust burden upon those subjected thereto. Such discrimination and classification are not founded upon a difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and are arbitrary and not reasonable and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(12) The provisions of the said Act and the decisions of the Treasury Department made in pursuance of the power conferred by said Act restrict the exemption as to normal tax for the tax year 1913 of a husband and wife living together and having separate incomes to a total joint exemption of $3,333.33 on their aggregate income, and for other tax years to a total joint exemption of $4,000 on their aggregate income and provide that an additional tax shall be paid, based upon the aggregate income of husband and wife living together and having separate incomes even if neither one has a separate income in excess of $20,000, while in the case of a husband and wife not living together and having separate incomes an exemption for the tax year 1913 of $2,500 is allowed to each, and an exemption for subsequent tax years is allowed of $3,000
34 to each, whereby the assessment and payment of a normal tax by a husband and wife not living together and having separate incomes, would fall upon neither if neither had a separate income of $3,000, and if either had a separate income of $3,000, would fall upon the excess or excesses, if any, over $3,000, and not upon the excess of the aggregate of both incomes over $4,000, and an additional tax by a husband and wife not living together and having separate incomes would fall upon neither if neither had a separate income in excess of $20,000, and if either had a separate income over $20,000 would fall upon the excess, or excesses, if any, over the $20,000 and not upon the excess of the aggregate of both incomes over $20,000. That such discriminations and classifications are based solely upon the circumstance that husband and wife are living together. That such discriminations and classifications do not rest upon any difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and are arbitrary and not reasonable, and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(13) The provisions of the said Act to the effect that nothing therein shall be construed to release a taxable person from liability for Income Tax lead to the result that, notwithstanding that the entire income tax of an individual might have been deducted and withheld at the source in pursuance of the requirements of the Act and the regulations of the Treasury Department made in pursuance of the power conferred thereby, in the event that the fidu-
35 ciary or other person deducting and withholding such a tax should neglect, or refuse, or be unable to pay the same when it became due, the individual whose normal tax had been deducted

and withheld would nevertheless be compelled to pay the same. In such a case compliance with the statute would result in a loss to the individual taxpayer of twice the amount of the normal tax, first, for the amount of the tax deducted and withheld from him, and, secondly, for the amount of the tax which he would be obliged to pay to the Government on the default of his fiduciary or withholding debtor. The Act, therefore, creates two classes of taxpayers, one, none of whose tax is deducted or withheld at the source, and the other composed of those whose tax is either in whole or in part deducted at the source. The Act imposes upon the latter class the risk of loss of twice the amount of the tax, with the certainty of such loss in the event of the neglect or refusal of the fiduciary or withholding debtor to pay the tax. Such discrimination and classification are founded upon a difference which bears no just relation to the act in respect to which the classification is proposed, and are arbitrary and not reasonable, and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(14) The provisions of the said Act of October 3, 1913, and the decisions of the Treasury Department made in pursuance of the power conferred by the said Act, while they do not permit an individual who either owns or rents property for family or personal use to deduct the rental value thereof, or rent actually paid therefor, expressly permit such owner to exclude such estimated rental of his home as income. Such a result gives a benefit and ad-
36 vantage to one who owns his home over one who rents it and is an exemption from taxable income of the rental value of a house to the owner thereof, while the renter of a house has no such exemption, as he is obliged to pay a tax on so much of his income as he expends in rent. If the renter cannot deduct as an expense what he pays as rent, the owner, who has no such expense, should be charged with the rental value of his home, to ensure reasonable uniformity and equality. The result aforesaid is substantial, for many individuals in the United States, especially those dwelling outside of the cities, many of whom are engaged in the business of farming, own and occupy homes of such rental value, that the inclusion of the rental value thereof in their taxable income would bring them within the taxable class or substantially increase their taxable incomes, whereas in consequence of the exclusion of such rental value, they are now wholly or partially exempt, while many renters, especially those living in cities or in the neighborhood thereof, are now taxable under said Act, who would be exempt or have their taxable incomes substantially reduced if they could exclude from their taxable incomes the rent they pay for their homes. Such a result effects a discrimination between and a classification into two classes, one of those individuals who own their homes and another of those who rent their homes. Such discrimination and classification are founded upon a difference which does not bear a reasonable and just relation to the act in respect to which the classification is proposed, and are arbitrary and not reasonable and are not founded upon a difference that the

restricted powers of the Federal Government permit to be the basis of classification.

37 (15) The provisions of the said Act of October 3, 1913, and the decisions of the Treasury Department made in pursuance of the power conferred by the said Act, do not require the inclusion in the aggregate of the taxable net income of the taxpayer of the value of any cattle, horses or other domestic animals that may be the offspring of any such animals owned by him and that have been born within the current year, and of the value of any grain, fruits, crops or other farm produce that he may have raised upon his land within the current year, that have not been sold and disposed of for valuable considerations, with the result that while the farmer is allowed a deduction from his net income of the expenses of carrying on his business, he is not obliged to include in his income the value of domestic animals born and produce raised in the year that may have been retained or consumed by his family or upon his farm. The said Act in paragraph B thereof expressly denies the right to deduct from net income "personal, living or family expenses"; nevertheless the farmer who raises during the current year upon his farm sufficient animals and produce to supply his family and who is not obliged to account for the value thereof as part of his net income, in effect is allowed to deduct from his net income his "personal, living or family expenses." The effect aforesaid of such provisions and decisions is to discriminate between and classify into two classes those individuals who pursue farming as a business and those who pursue another or no business. Such discrimination and classification are founded upon a difference which does not bear a reasonable and just relation to the Act in respect to which the classification is

38 proposed, are arbitrary and not reasonable; and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(16) If the provisions of the said Act of October 3, 1913, are held to be unconstitutional and void with respect to individuals, they are equally so with respect to corporations. The said Act does not purport to impose an excise upon the carrying on or the doing of business in a corporate or quasi-corporate capacity, measured by the net income of corporations, but does purport to impose a tax upon the net income of corporations who carry on the same businesses as are carried on by individuals and derive their incomes from the same sources as individuals. A tax upon the net income of corporations alone that did not fall upon the net income of individuals would result in a discrimination between and a classification into two classes for purposes of taxation of corporations and individuals, which would be founded upon a difference which does not bear a reasonable and just relation to the act in respect to which the classification is proposed, and are arbitrary and not reasonable and violate the rule of equality of burden between direct competitors and are not founded upon a difference that the restricted powers of the Federal Government permit to be the basis of classification.

(17) It is provided in the said Act of October 3, 1913, that

the said Section II of said Act shall not apply to mutual savings banks not having a capital stock represented by shares, or to fraternal benaficiary societies, orders or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity, itself operating under the lodge system, and providing for the payment of life, sick, accident or other benefits to the members of such societies, orders or associations, and dependents of such members, nor to domestic building and loan associations. Such provisions of the said Act create a discrimination and a classification in favor of said mutual savings banks, fraternal beneficiary societies, orders and associations, and building and loan associations, as against other corporations which conduct their business solely for the benefit of the members of such corporations and which corporations, under the provisions of the said Act of October 3, 1913, are required to pay a tax upon net income and such discrimination and classification are unreasonable and arbitrary. There is no reason that justifies the exemption of fraternal beneficiary societies, orders and associations from the payment of an income tax that does not require the exemption from an income tax of mutual life insurance companies. A fraternal association has no capital stock and is organized and carried on solely for the mutual benefit of its members and their beneficiaries and not for profit. Mutual life insurance companies have no capital stock, and they are carried on solely for the benefit of the policyholders and beneficiaries. Both classes of companies equally are not engaged in business for gain. The entire assets of mutual life insurance companies belong to the policyholders. The number of fraternal organizations, orders and associations doing business in the United States is large. Their total annual income for many years back has been in excess of $100,000,000; their total yearly disbursements have been in excess of $100,000,000. Said fraternal societies, orders and associations have assets amounting to upwards of $163,000,000 and the business annually conducted by such fraternal associations is in excess of $1,000,000,000. Mutual savings banks, which, by the provisions of the said Act of October 3, 1913, are entirely exempt from the provisions of Section II of said Act, had in June, 1913, total resources of over $4,000,000,000, loans and discounts of over $2,000,000,000, bonds, securities, etc., over $1,800,000,000, and individual deposits of over $3,700,000,000. The building and loan associations of the United States for the year ending 1913 had total assets of over $1,000,000,000. The provisions of the said Act exempting the aforesaid corporations and imposing a tax upon other business corporations creates a discrimination and a classification which are arbitrary and unreasonable. All the aforesaid discriminations and classifications are violative of the Fifth Amendment of the Constitution of the United States.

Fourteenth. That the said Act is invalid in that it unlawfully delegates to the Secretary of the Treasury to decide in certain cases that the accumulation of surplus of the gains and profits of a corporation, joint stock company or association, instead of its being

divided and distributed, is prima facie evidence of a fraudulent purpose to escape the Income Tax, by certification that in the opinion of the said Secretary such accumulation is unreasonable for the purposes of the business. That such provisions delegate judicial authority to the said Secretary to make a decision by certifying his opinion that shall be taken by the courts in pending litigation as prima facie evidence of a purpose to escape the tax. That
41 such delegation of authority is unlawful and in contravention of the provisions of the Constitution of the United States and confers judicial powers on the Secretary of the Treasury for the time being.

Fifteenth. That the aforesaid provisions of said Act of October 3, 1913, constitute one entire independent system of taxation, and inasmuch as said provisions are unconstitutional and void for the reasons and in respect to the matters hereinbefore stated, the said provisions are in all respects unconstitutional and void, and any tax which may be levied thereunder upon the defendant is and will be unconstitutional and void, not only to the extent that it is unconstitutional as to the matters hereinbefore set forth but in each and every respect and as to the whole thereof.

Sixteenth. Your orator further avers that this suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance, and that your orator has protested to the defendant and to the Directors of said defendant against the compliance by said corporation, and by said Directors, with the provisions of the Act of Congress hereinbefore referred to, and has claimed before said Board of Directors that the said provisions with respect to taxes, both upon the net income of the Union Pacific Railroad Company and coupons and registered interest owned by and payable to individuals, are unconstitutional, and has protested against any action by the Company or its Directors in voluntarily complying with the provisions of said Act and requested that said Company and its Directors should refrain from voluntarily complying with any of said provisions and from voluntarily making any return in pursuance thereof and
42 from voluntarily paying any taxes provided for therein, either upon its own net income or upon such coupons and registered interest, and has claimed to said Directors that the payment of any such taxes would be a waste and misappropriation of the assets of the Company, and has requested that the Company and its Directors should contest the constitutionality of said Act and prevent an unconstitutional and improper diversion of the assets of the corporation in the payment of any such tax, and should apply to a court of competent jurisdiction to determine the liability of the Company under said Act and take such steps as should be necessary to protect the rights of the Company's shareholders.

Your orator further avers that the said company has neglected to comply with any of your orator's requests, as aforesaid, and has stated to your orator that it does not feel at liberty to disregard the corporation income tax provisions, and the provisions for the collection at the sources of individual income taxes contained in the

Act of October 3, 1913, and to incur thereby the heavy penalties which might result from such disregard, and has refused specifically each of your orator's aforesaid requests, and said company intends and threatens to comply with the said Act and the provisions thereof in all respects.

That annexed hereto and marked respectively Exhibits A and B are copies of letters, one of which, A, was sent by your orator to said defendant, and the other of which, B, is the reply thereto received by your orator.

Your orator further shows that he has been and is unable to have the said action by the Board of Directors reviewed and rescinded or modified by the general body of stockholders of said corporation and to have such stockholders direct the said Board of Directors to comply with your orator's demand, inasmuch as no pro-
43 vision is made in the Act of the Legislature of Utah, incorporating the defendant, or by the by-laws of the Company, or general laws of the State of Utah relating to corporations, binding upon the defendant, for such control by the general body of stockholders of the acts of the Board of Directors, and for the further reason that the next annual meeting of said corporation will not take place until the second Tuesday of October, 1914, and by the Act of Congress hereinbefore referred to payment of said taxes is required to be made on the 30th day of June, 1914.

That special meetings of defendant's stockholders by its by-laws can only be had upon order of the Board of Directors or Executive Committee or by written application of stockholders owning not less than one-third in amount of the capital stock. That in view of the position taken by the Executive Committee of defendant set forth in Exhibit B hereto annexed, it would be useless to apply to said Committee or the Board to call a special meeting of stockholders. That in view of the large number of stockholders holding over $300,000,000 of stock, and the necessity of publication of notice of a special meeting for three weeks, it would be practically impossible to obtain the cooperation of a sufficient number of stockholders and the publication of notice aforesaid within any reasonable time in the future, and probably not at all.

Seventeenth. Your orator further avers that the making of the aforesaid returns and payment of the aforesaid taxes will result in a great diversion and misappropriation of the assets of the defendant corporation, and will unconstitutionally lessen and diminish the equity of the shareholders in said corporation and the interest of your orator in said corporation as a shareholder therein will be greatly and irreparably injured thereby.

44 Eighteenth. Your orator further avers that unless this Court shall grant to your orator the relief hereinafter prayed, the defendant will pay the aforesaid taxes for the past year and each year in the future, and said Company will be obliged to submit wholly to such unconstitutional taxes and to suffer great loss therefrom and to lose the taxes unnecessarily paid for those who are exempt, or in each year to go to great expense to ascertain which of its coupon and interest payees are exempt from the operation of

the Act and to bring numerous suits against the officers of the Government of the United States to recover back the taxes paid as aforesaid. That the issues to be determined in all such suits brought as aforesaid involving the validity of said Act of October 3, 1913, would be substantially identical with those to be passed upon herein and can be determined more speedily and conveniently by the Court in this suit, and the granting of the relief hereinafter prayed will prevent such multiplicity of suits as aforesaid.

Nineteenth. Your orator further shows the amount of the taxes upon the net income of the defendant for the year 1913 exceeds the amount of $300,000 and that the taxes heretofore deducted and withheld and payable by defendant in conformity with the provisions of the said Act on the thirtieth day of June, 1914, on behalf of holders of coupons and payees of registered interest on its bonds aforesaid, who have not claimed exemption and with respect to whom the defendant has covenanted to pay taxes required to be withheld amount to over the sum of $6,000; that the matter in dispute herein, exclusive of interest and costs, exceeds the sum or value of $3,000. Inasmuch, therefore, as your orator has no adequate remedy at law for its aforesaid grievances and can have relief only in equity,
45 your orator files this bill of complaint in behalf of himself and behalf of all other shareholders who may come in and join in the prosecution and contribute to the expense of this suit, and prays for equitable relief as follows:

(1) That the provisions relating to making returns of net income and payment of taxes imposed upon the net income of corporations, joint stock companies or associations and insurance companies, contained in the said Act of Congress of October 3, 1913, and particularly with respect to the period between March 1st, 1913 and October 3d, 1913, so far as any tax is sought to be imposed thereby upon the defendant Union Pacific Railroad Company, may be adjudged unconstitutional and void.

(2) That the defendant may be perpetually restrained from voluntarily making or causing to be made any return or statement pursuant to said provisions and voluntarily paying or causing to be paid any tax that may be imposed thereunder and particularly from voluntarily making or causing to be made any such return or statement and from voluntarily paying any tax for the period between March 1st, 1913 and October 3d, 1913, and from voluntarily paying any taxes upon income received as dividends upon the stocks of corporations held by it, which are subject to taxation under said Act.

(3) That the provisions relating to deducting and withholding taxes upon income of individuals arising or accruing from coupons or registered interest and making returns with respect to such amounts so withheld and paying such amounts to any Collector of Internal Revenue of the Government of the United States, or any other person, contained in the Act of Congress aforesaid, may be adjudged unconstitutional and void.

46 (4) That the defendant may be perpetually restrained from voluntarily making or causing to be made any return

pursuant to said provisions relative to said taxes upon coupons or registered interest payable to individuals, and from deducting or withholding any such tax or voluntarily paying any such taxes to any Collector of Internal Revenue or any other officer of the United States Government.

(5) That pending such final decree as this Honorable Court may see fit to make herein, a temporary injunction may issue, restraining the said defendant from voluntarily doing or performing any of the aforesaid acts with respect to which a final decree is hereinabove prayed.

(6) That the above named defendant may be required to answer all and singular the matters above stated.

(7) That a writ of subpœna may be granted to your orator, to be directed to the Union Pacific Railroad Company, thereby requiring said defendant personally to appear on a certain day before the Court, then and there full, true, direct and perfect answer to make (but not under oath, which is hereby expressly waived) to all and singular the premises, and further to perform and abide by such further order, direction or decree thereof as to the Court may seem meet.

(8) That your orator may have such other and further relief as the Court may deem proper and equitable, and your orator will ever pray, etc.

DAVIES, AUERBACH & CORNELL,
Solicitors for Complainant.

JULIEN T. DAVIES,
JOSEPH S. AUERBACH,
FREDERIC J. FULLER,
Of Counsel.

47 UNITED STATES OF AMERICA,
Southern District of New York,
City and County of New York, ss:

Frank R. Brushaber, being duly sworn, deposes and says that he is the above-named complainant; that he has read the foregoing bill of complaint, and the same is true of his own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters he believes it to be true.

FRANK R. BRUSHABER.

Sworn to before me this 13th day of March, 1914.

AMOS J. PEASLEE,
Notary Public, County of New York, State of New York, No. 3059. *New York County Register No.* 5138.

My Commission expires March 30, 1915.

48 EXHIBIT A.

FEBRUARY 27, 1914.

To the Union Pacific Railroad Company and to the Board of Directors Thereof.

SIRS: I am a stockholder of record of the Union Pacific Railroad Company and am informed that the Company intends to voluntarily comply with the requirements of the provisions of the so-called Income Tax imposed by Section 2 of the Act of Congress of the United States entitled "An Act to reduce tariff duties and to provide revenue for the Government and for other purposes," which Act became a law October 3, 1913 and is known as the Tariff Act. I am further informed that the Company intends to make returns pursuant to and in compliance with said Act and to pay such tax as may be assessed upon it in accordance therewith. I am also informed that the Company has withheld and intends in the future to withhold the normal tax of one per cent. imposed upon the coupon and registered interest owned by and payable to individuals, and to make returns to the Government with respect to said taxes and to pay said taxes.

I desire to notify you that I claim that the provisions of said act of Congress in respect to such taxes, both upon the net income of the Union Pacific Railroad Company and said coupons and registered interest owned by and payable to individuals, are unconstitutional. As a shareholder in said Company, I hereby protest against any action by the Company and its Directors in voluntarily complying with the provisions of said Act, and I request that said Company and its Directors shall refrain from voluntarily complying
49 with any of said provisions and from voluntarily making any return in pursuant thereto and from voluntarily paying any taxes provided for therein, either upon its own net income or upon such coupons and registered interest.

I further claim that the payment of any such tax would be a waste and misappropriation of the assets of the Company.

I further request that the Company and its Directors shall test the constitutionality of said Act and prevent an unconstitutional and improper diversion of the assets of the corporation in the payment of any such tax, and shall apply to a court of competent jurisdiction to determine the liability of the Company under said Act, and take such steps as shall be necessary to protect the rights of the Company's shareholders.

Unless I shall be informed within a reasonable time that it is your purpose to comply with my requests herein made, I shall consider that you have refused so to do and shall feel justified in alleging your refusal as a basis for any independent action that I may take to protect the interests of the Company and its shareholders in the premises.

I remain, very truly yours,

FRANK R. BRUSHABER.

50 EXHIBIT B.

Copy.

Union Pacific Railroad Company,

Law Department,

165 Broadway,

NEW YORK, *March* 6, 1914.

Henry W. Clark, Counsel.
George Adams Ellis, Assistant Counsel.

Mr. Julien T. Davies, 34 Nassau St., City.

DEAR SIR: Referring to communication received from you, dated February 27, 1914, signed by Mr. Frank R. Brushaber a stockholder of this Company.

This Company does not feel at liberty to disregard the corporation income tax provisions and the provisions for the collection at the source of individual income taxes contained in the Act of October 3, 1913, and to incur thereby the heavy penalties which might result from such disregard. The Company has therefore been making returns to the Collector of Internal Revenue of interest payments, taxes withheld thereon, etc., and purposes to make return of its net income as a corporation under the provisions of subsection G of the Act.

The course which is being followed by the officers of the Company has received such sanction from the Executive Committee of the Board of Directors after consideration of the Income Tax Act that the various requests contained in Mr. Brushaber's letter must be specifically refused.

Very truly yours,

HENRY W. CLARK.

51 United States District Court, Southern District of New York.
In Equity.

Docket No. E-11-121.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant.

To the Clerk of the United States District Court for the Southern District of New York:

Please enter my appearance as solicitor for the defendant in the above entitled cause.

April 4, 1914.

HENRY W. CLARK,
Solicitor for Defendant.

Office and Post Office Address, 165 Broadway, New York City, N. Y.

(Filed Apr. 4, 1914.)

52 United States District Court, Southern District of New York.
In Equity.

Docket No. E 11, p. 121.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant.

Now comes the defendant and moves that the bill of complaint herein be dismissed upon the ground that Section 2 of the Act of the First Session of the Sixty-third Congress, which became a law on October 3, 1913, generally known as the "Tariff Act", and set forth in the bill of complaint herein, is constitutional and valid, and that the complainant has not in and by said bill made or stated such a cause as doth or ought to entitle him to any such relief as is therein sought and prayed from or against this defendant; and said motion will be brought on for hearing before this Court at a term thereof to be held in the United States Post Office Building in the Borough of Manhattan, City of New York, on the 24th day of April, 1914, at 10:30 o'clock in the forenoon, or as soon thereafter as counsel can be heard.

Dated, April 20, 1914.

HENRY W. CLARK,
Solicitor for Defendant,
165 *Broadway, New York City.*

To Davies, Auerbach & Cornell, Solicitors for complainant, 32 Nassau Street, New York City.

Due and timely service of the foregoing notice of motion this 21st day of April, 1914, is hereby admitted.

(Signed) D., A. & C.,
Solicitors for Complainant.

(Filed Apr. 25, 1914.)

53 In the District Court of the United States for the Southern District of New York. In Equity.

Docket No. E 11, p. 121.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant.

This cause came on to be heard at the April Term of this Court, 1914, and thereupon, after hearing counsel, and upon consideration thereof, it was

Ordered, adjudged and decreed that the motion of the defendant to dismiss the bill of complaint herein, upon the ground that Section 2 of the Act of the First Session of the Sixty-third Congress, which became a law on October 3, 1913, generally known as the "Tariff Act" and set forth in the bill of complaint herein, is constitutional and valid and that the complainant has not in and by said bill made or stated such a cause as doth or ought to entitle him to any such relief as is therein sought and prayed from or against this defendant, be and the same hereby is granted, and that the said bill of complaint be and the same hereby is dismissed, with costs to be taxed by the Clerk.

Dated, this 24th day of April, 1914.

H. G. WARD,
United States Circuit Judge.

Notice of settlement waived:
DAVIES, AUERBACH & CORNELL,
Solicitors for Complainant.

(Filed Apr. 25, 1914.)

54 In the District Court of the United States for the Southern District of New York. In Equity.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant.

To the judges of the District Court of the United States for the Southern District of New York:

The above-named complainant considering himself aggrieved by the decree made and entered by the above-mentioned court in the

above entitled cause, on the — day of April, 1914, wherein and whereby it was ordered, adjudged and decreed that the motion of the defendant to dismiss the bill of complaint be sustained and that this cause be dismissed, does hereby appeal to the United States Supreme Court from said decree; and complainant prays that this his appeal may be allowed and that a transcript of the record and the proceedings and papers upon which said decree was made, duly authenticated, may be sent to the Supreme Court of the United States.

Dated, New York, April 24th, 1914.

DAVIES, AUERBACH & CORNELL,
Solicitors for Complainant.

Appeal allowed.
H. G. WARD, *U. S. J.*

(Filed Apr. 25, 1914.)

55 In the District Court of the United States for the Southern District of New York.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY Defendant.

Assignment of Errors.

Now comes the complainant and files the following assignment of errors upon which it will rely upon its appeal from the decree made by this Honorable Court on the — day of April, 1914, in the above entitled cause:

First. That the court erred in granting the motion made by the defendant to dismiss the bill of complaint herein and in holding that the said bill was without equity.

Second. That the court erred in adjudging that Section 2 of the Act of the First Session of the Sixty-third Congress, which became a law on October 3, 1913, generally known as the "Tariff Act", set forth in the bill of complaint herein, is constitutional and valid and that the said section was not violative of the third clause of the Second Section of Article I. and the fourth clause of the Ninth Section of Article I. and the first clause of the Eighth Section of Article I. and the implied limitations and restrictions upon the taxing
56 power of the United States contained in the Constitution of the United States and of Articles IV., V. and X. of the Amendments to the Constitution of the United States.

Third. That the court erred in adjudging that the provisions of Section 2 of the Act hereinabove referred to, set forth in the bill of complaint herein, relating to making returns of net income and payment of taxes imposed upon the net income of corporations, joint stock companies and associations, or insurance companies, so far as any tax is sought to be imposed thereby upon the defendant Union Pacific Railroad Company, are constitutional and valid.

Fourth. That the court erred in adjudging that the provisions of Section 2 of the Act hereinabove referred to, set forth in the bill of complaint herein, relating to making returns of net income and payment of taxes imposed upon the net income of corporations, joint stock companies or associations and insurance companies, so far as any tax is sought to be imposed thereby upon the property of the defendant Union Pacific Railroad Company, acquired through the receipt of income prior to the passage of said Act, are constitutional and valid.

Fifth. That the court erred in adjudging that the provisions of Section 2 of the Act hereinabove mentioned, set forth in the bill of complaint herein, relating to making returns of net income and payment of taxes imposed upon the net income of corporations, joint stock companies or associations and insurance companies, so far as any tax is sought to be imposed thereby upon the income of
57 the defendant Union Pacific Railroad Company, received as dividends upon the stocks of corporations held by it which are also subject to taxation upon their net income under said Act, are constitutional and valid.

Sixth. That the court erred in adjudging that the provisions of Section 2 of the Act hereinabove referred to, set forth in the bill of complaint herein, relating to deducting and withholding taxes upon income of individuals arising or accruing from coupons or registered interest, and making returns with respect to such amounts so withheld, are constitutional and valid.

Seventh. That the court erred in holding that the provisions of Section 2 of the Act hereinabove mentioned, set forth in the bill of complaint herein, relating to deducting and withholding a certain proportion of the indebtedness of corporations arising or accruing from coupons or registered interest, so far as the duty is sought to be imposed thereby upon the defendant Union Pacific Railroad Company of making such deductions from the amounts payable for coupons or registered interest, and of paying the same to the Collector of Internal Revenue of the government of the United States, or any other person, irrespective of the taxable status of the income of the persons receiving such registered or coupon interest, and without knowledge or means of knowledge of the taxable status of the income of such persons, are constitutional and valid.

58 Eighth. That the court erred in not decreeing that the complainant was entitled to the relief prayed for or some part thereof.

Ninth. That the court erred in dismissing said bill with costs.

Wherefore, the appellant, complainant in the court below, prays that the decree of said court may be reversed; and in order that the foregoing assignment of errors may be part of the record the complainant presents the same to the court and prays that such disposition may be made thereof as in accordance with law and the statutes of the United States in such case made and provided.

All of which is respectfully submitted.

DAVIES, AUERBACH & CORNELL,
Solicitors for Complainant.

Filed April 25, 1914.

5—1045

59 In the District Court of the United States for the Southern District of New York.

In Equity.

FRANK R. BRUSHABER, Complainant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant.

On motion of Messrs. Davies, Auerbach & Cornell, solicitors for the complainant, it is

Ordered that the appeal to the Supreme Court of the United States from the final decree filed and entered herein on the 24th day of April, 1914, be and the same hereby is allowed, and that a certified transcript of the record and all proceedings herein be forthwith transmitted to the United States Supreme Court, at Washington, D. C.; and it is further

Ordered that the bond on appeal be fixed at the sum of $250.00—the same to act as a supersedeas bond and also as a bond for any costs and damages on appeal.

Dated, April 24th, 1914.

H. G. WARD,
Judge of the District Court of the United States for the Southern District of New York.

(Filed Apr. 25, 1914.)

60 District Court of the United States of America for the Southern District of New York, in the Second Circuit.

In Equity.

FRANK R. BRUSHABER, Complainant-Appellant,
against
UNION PACIFIC RAILROAD COMPANY, Defendant-Respondent.

Bond on Appeal.

Know all men by these presents, That Frank R. Brushaber as principal, and National Surety Company, a corporation under the laws of the State of New York, with its principal place of business at No. 115 Broadway, in the City, County and State of New York, as surety, are held and firmly bound unto the above named Union Pacific Railroad Company in the sum of Two Hundred Fifty ($250.00) Dollars to be paid to the said Union Pacific Railroad Company for the payment of which well and truly to be made, said principal and surety bind themselves, their heirs, executors, administrators and assigns, jointly and severally, firmly by these presents. Sealed and dated the 24th day of April 1914.

Whereas, the above named Frank R. Brushaber has prosecuted an appeal to the United States Circuit Court of Appeals for the Second Circuit, to reverse the decree rendered in the above entitled suit, by a Judge of the District Court of the United States for the Southern District of New York.

Now, therefore, the condition of this obligation is such, that if the above named Frank R. Brushaber shall prosecute said appeal to effect, and answer all damages and costs if he fail to make said appeal good, then this obligation shall be void, otherwise the same shall be and remain in full force and virtue.

NATIONAL SURETY COMPANY,
By L. M. C. ADAMS,
Resident Vice-President.

Attest:

E. M. McCARTHY,
Resident Assistant Secretary.

STATE OF NEW YORK,
County of New York, ss:

On this — day of ——, 191–, before me personally came the within named —— —— to me known, and known to me to be the individual described in and who executed the within bond and — acknowledged that — executed the same.

—— ——.

61 *Affidavit, Acknowledgment, and Justification by Guarantee or Surety Company.*

STATE OF NEW YORK,
County of New York, ss:

On this 24th day of April 1914 before me personally came L. M. C. Adams, known to me to be the Resident Vice-President of National Surety Company, the corporation described in and which executed the foregoing Bond of Frank R. Brushaber as surety and who, being by me duly sworn, did depose and say that he resides in the City of New York, State of New York; that he is the Resident Vice-President of said Company, and knows the corporate seal thereof; that the said National Surety Company is duly incorporated under the laws of the State of New York, that said Company has complied with the provisions of the Act of Congress of August 13, 1894, that the seal affixed to the within Bond of Frank R. Brushaber is the corporate seal of said National Surety Company, and was thereto affixed by authority of the Board of Directors of said Company, and that he signed his name thereto by like authority as Resident Vice-President of said Ceompany, and that he is acquainted with E. M. McCarthy and knows him to be the Resident Assistant Secretary of said Company; and that the signature of said E. M. McCarthy subscribed to said Bond is in the genuine handwriting of said E. M. McCarthy, and was thereto sub-

scribed by order and authority of said Board of Directors, and in the presence of said deponent; and that the assets of said Company, unencumbered and liable to execution exceed its debts and liabilities of every nature whatsoever, by more than the sum of two million dollars.

L. M. C. ADAMS.
(Deponent's Signature.)

Signed, sworn to, and acknowledged before me this 24th day of April 1914.

WM. M. WEAVER,
Notary Public, etc.

STATE OF NEW YORK,
County of New York, ss:

On this — day of ——, 191–, before me personally came —— ——; to me known, who, being by me duly sworn, did depose and say that he resides in —; that he is the — of the — the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of the said corporation, and that he signed his name to the said instrument by like order.

—— ——.

[Endorsed:] District Court of United States, Southern District of New York. Frank R. Brushaber, Complainant-Appellant, against Union Pacific Railroad Company, Defendant-Respondent. Bond on Appeal. Surety, National Surety Company. Filed April 25th, 1914. Attorney for —. I approve of the *written* Bond, and of the sufficiency of the surety thereon. H. G. Ward, U. S. J.

62 UNITED STATES OF AMERICA, *ss:*

The President of the United States to Union Pacific Railroad Company, Greeting:

You are hereby cited and admonished to be and appear at the Supreme Court of the United States at the City of Washington within thirty days from the date of this writ, towit on the 4th day of May pursuant to an appeal allowed by a Judge of the District Court of the United States for the Southern District of New York in the Second Circuit, filed in the Clerk's office of the District Court of the United States for the Southern District of New York, in a cause wherein Frank R. Brushaber is appellant and you are appellee, to show cause, if any, why the decree entered against the said appellant as in the said appeal mentioned, should not be corrected, and why speedy justice should not be done to the parties in that behalf.

Witness, the Hon. H. G. Ward, Judge of the District Court of the United States for the Southern District of New York in the Second Circuit at the Borough of Manhattan in the City of New York, in the District and Circuit above named, this 24th day of

April in the year of Our Lord One thousand nine hundred and fourteen.

H. G. WARD, *U. S. J.*

(Filed Apr. 25, 1914.)

Endorsed.

(Service admitted this 25th day of April, 1914.
HENRY W. CLARK,
Solicitor for Appellee.)

63 United States District Court, Southern District of New York.

FRANK R. BRUSHABER, Complainant,
vs.
UNION PACIFIC RAILROAD COMPANY, Defendant.

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

Dated, April 29, 1914.

DAVIES, AUERBACH & CORNELL,
Attorneys for Complainant.
HENRY W. CLARK,
Attorney for Defendant.

(Filed April 30th 1914.)

64 UNITED STATES OF AMERICA,
Southern District of New York, ss:

FRANK R. BRUSHABER, Complainant,
vs.
UNION PACIFIC RAILROAD COMPANY, Defendant.

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby Certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this 30th day of April in the year of our Lord one thousand nine hundred and fourteen and of the Independence of the said United States the one hundred and thirty-eighth.

[Seal District Court of the United States, Southern District of N. Y.]

ALEX. GILCHRIST, JR., *Clerk.*

Endorsed on cover: File No. 24,196. S. New York D. C. U. S. Term No. 1045. Frank R. Brushaber, appellant, vs. Union Pacific Railroad Company. Filed May 4th, 1914. File No. 24,196.

FILED
APR 23 1915
JAMES D. MAHER
CLERK

Supreme Court of the United States,

OCTOBER TERM, 1914.

FRANK R. BRUSHABER,
Appellant,

against

UNION PACIFIC RAILROAD COMPANY,
Appellee.

No. [redacted] 140

AND TWO OTHER CASES,

Nos. ~~868 and 869.~~ 393 + 24

(COPY)

MOTION TO ADVANCE.

JULIEN T. DAVIES,
Counsel for Appellants and Plaintiffs-in-Error,
Mutual Life Building,
34 NASSAU STREET,
New York City.

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1914.

FRANK R. BRUSHABER, Appellant, *against* UNION PACIFIC RAILROAD COMPANY, Appellee.	No. 465.
TYEE REALTY COMPANY, Plaintiff-in-Error, *against* CHARLES W. ANDERSON, Collector of International Revenue, Defendant-in-Error.	No. 868.
EDWIN THORNE, Plaintiff-in-Error, *against* CHARLES W. ANDERSON, Collector of International Revenue, Defendant-in-Error.	No. 869.

Now comes Frank R. Brushaber, appellant in case No. 465 above entitled, and respectfully shows to the court that the said case is an appeal from the District Court of the United States for the Southern District of New York; that the transcript of record was filed May 4, 1914, and has been printed; that said appeal is from a final decree of the said District Court dismissing a bill of

complaint filed by said Frank R. Brushaber as a stockholder of the Union Pacific Railroad Company against said Company as defendant, for an injunction restraining said defendant from complying with the provisions of Section II of the Act of Congress approved October 3, 1913, entitled "An Act to reduce tariff duties and provide revenue for the Government and for other purposes," upon the ground that said Section is unconstitutional and void and that compliance therewith would constitute a waste of the assets of the defendant corporation; that by said bill and by the assignments of error upon said appeal there is presented not only the question of the constitutionality of said Section as a whole, but also, among other things, the question of the constitutionality of the provisions requiring the deduction and withholding of taxes upon the income of individuals arising or accruing from coupons or registered interest, the constitutionality of provisions limiting the amount of indebtedness of corporations upon which interest may be deducted in ascertaining the taxable net income of such corporations, the constitutionality of provisions imposing a tax upon that part of the net income of corporations which is derived from the net earnings of other corporations subject to like tax, together with the constitutionality of provisions involving other classifications, discriminations and inequalities which are charged in the bill to be unconstitutional and void.

Comes also Tyee Realty Company, plaintiff-in-error in case No. 868 above entitled, and shows to the court that said case is brought in this court upon a writ of error to the District Court of the United States for the Southern District of New York to review a final judgment dismissing the complaint; that the transcript of record

was filed March 12, 1915, and has been printed; that the said action was brought by said Tyee Realty Company as plaintiff against Charles W. Anderson as Collector of Internal Revenue for the Second Collection District of the State of New York as defendant, to recover a tax assessed against the said plaintiff by the Commissioner of Internal Revenue under the alleged authority of Section II of the said Act approved October 3, 1913, which tax had been paid by the plaintiff to the defendant under protest and under duress; that by said complaint and the assignments of error in said case there are presented not only the question of the constitutionality of said Section as a whole, but also, among other things, the question of the constitutionality of the provisions of said Section designed to regulate the internal affairs of corporations organized and existing under the authority of the several States in respect to their plan or method of capitalization.

Comes also Edwin Thorne, plaintiff-in-error in case No. 869 above entitled, and shows to the court that the said case was brought in this court upon a writ of error to the District Court of the United States for the Southern District of New York to review a final judgment of said court dismissing the complaint; that the transcript of record was filed March 12, 1915, and has been printed; that the said action was brought by said Edwin Thorne as plaintiff against Charles W. Anderson as Collector of Internal Revenue for the Second Collection District of the State of New York as defendant, to recover a tax assessed against the said plaintiff by the Commissioner of Internal Revenue under the alleged authority of Section II of the said Act approved October 3, 1913, which tax had been paid by the plaintiff to the defendant under protest and under duress; that by said complaint and

the assignments of error in said case there are presented not only the question of the constitutionality of said Section as a whole, but also, among other things, the constitutionality of the provisions for the taxation of individuals having incomes exceeding twenty thousand dollars annually at varying rates in excess of the normal tax, according to the amount of their incomes.

And the said Frank R. Brushaber, Tyee Realty Company and Edwin Thorne show further that the questions involved in said cases are questions of great public interest both as affecting the revenues of the government and the rights and interests of persons and corporations assessed for taxation pursuant to said Section; that a decision of said cases before December 1, 1915, is desirable in order that Congress may have opportunity to take any action deemed necessary or advisable in view of such decision before the time appointed for assessing the tax for the year 1915; that it will not be possible for said cases to be reached for argument in time to permit of such a decision unless they be advanced; that it is not the object of said appeal or said writs of error to question the general authority of Congress to establish an income tax for the purpose of producing revenue, but mainly to challenge the authority of Congress to enact provisions that under the guise of imposing an income tax actually and in effect exact from citizens pecuniary contributions based upon discriminations and classifications that are founded upon differences that bear no just relation to the act in respect to which the classification is proposed and that are arbitrary and unreasonable and actually and in effect penalize individuals and corporations who do not conform to certain standards of wealth or organization set up by Congress in the said Act.

The said appellant and the said plaintiffs-in-error therefore pray that these cases may be advanced to be heard together and assigned for argument on such day as the court may fix.

Dated New York, April 15, 1915.

JULIEN T. DAVIES,
Of Counsel for Frank R. Brushaber, Appellant,
and Tyee Realty Company and Edwin Thorne,
Plaintiffs-in-Error.

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1914.

FRANK R. BRUSHABER, Appellant, *against* UNION PACIFIC RAILROAD COMPANY, Appellee.	No. 465.
TYEE REALTY COMPANY, Plaintiff-in-Error, *against* CHARLES W. ANDERSON, Collector of International Revenue, Defendant-in-Error.	No. 868.
EDWIN THORNE, Plaintiff-in-Error, *against* CHARLES W. ANDERSON, Collector of International Revenue, Defendant-in-Error.	No. 869.

SIRS:

YOU WILL PLEASE TAKE NOTICE that a motion, of which a copy is hereto annexed, will be presented to the Supreme Court, at a Term thereof to be held at the Capitol in the City of Washington, on the 26th day of April, A. D.

1915, at the opening of court on that day or as soon thereafter as counsel can be heard.

Dated, April 15th, 1915.

JULIEN T. DAVIES,
Of Counsel for Frank R. Brushaber, Appellant, and Tyee Realty Company and Edwin Thorne, Plaintiffs-in-Error.

To HENRY W. CLARK, ESQ.,
Solicitor for Union Pacific Railroad Company, Appellee.

H. SNOWDEN MARSHALL, ESQ.,
United States Attorney for the Southern District of New York,
Solicitor for Charles W. Anderson, Defendant-in-Error.

HON. THOMAS W. GREGORY,
Attorney-General of the United States.

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Supreme Court of the United States.

OCTOBER TERM, 1915.
No. 140.

FRANK R. BRUSHABER,
Appellant,

against

UNION PACIFIC RAILROAD COMPANY,
Appellee.

BRIEF FOR APPELLANT.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Martin A. Schenck.

Of Counsel.

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Supreme Court of the United States.

OCTOBER TERM, 1915.

FRANK R. BRUSHABER, Appellant, AGAINST UNION PACIFIC RAILROAD COMPANY, Appellee.	No. 140.

BRIEF FOR APPELLANT.

In this case the Court is asked to review the record made up by the final judgment of the District Court for the Southern District of New York, dismissing the cause on demurrer.

The case presents the constitutionality of certain provisions of the Income Tax Law of 1913, constituting Section 2 of the Act of October 3, 1913, adopted at the first session of the Sixty-third Congress, and entitled "An Act to Reduce Tariff Duties and Provide Revenue for the Government and for Other Purposes".

The action was brought on the equity side of the Court by the appellant, a stockholder of the defendant, to enjoin the latter from complying with the provisions of said statute, including the making of returns and paying taxes deducted from the income of others.

Statement of Facts.

The bill avers as follows: The defendant is a Utah corporation, with its executive offices in New York City. By its charter and By-Laws the general control of its business and affairs is entrusted to the directors as a board and an executive committee of that board. The plaintiff owns 500 shares of the defendant's stock (Rec., pp. 2–3).

The defendant has charter power to engage in business as a common carrier operating a line of railway for that purpose and also to mortgage its lines, to acquire property including the stocks of other railroad corporations, and to operate, by lease or by contract, lines of railroad belonging to other companies. Its outstanding preferred stock amounts in par value to ninety-nine million five hundred forty-three thousand five hundred dollars ($99,543,500) and its common stock to two hundred sixteen million six hundred thirty-three thousand nine hundred dollars ($216,633,900). Upon both of these classes of stock, dividends have been paid for many years. Pursuant to its charter power, the Company has outstanding bonds as follows:

$100,000,000 par value of fifty-year four per cent. gold bonds due July 1, 1947, with interest payable semi-annually; secured by first mortgage dated July 1, 1897, including certain assets;

$65,085,280 of first lien and refunding mortgage bonds due June 1, 2008, with interest payable semi-annually; secured by mortgage dated June 1, 1908, covering certain lines of railroad.

$37,435,700 twenty-year convertible bonds due July 1, 1927, with interest payable semi-annually; secured by mortgage dated July 1, 1907.

All bonds of each series contain the common "tax free clause" obligating the mortgagor to pay

the principal and interest of the bonds without deduction for any taxes which the Company may be required to pay or retain therefrom under any present or future law of the United States, or of any state or political sub-division thereof (Rec., pp. 3–4).

The bill then recites the adoption of the Tariff Act of October 3, 1913, the second section of which contains the income tax law, and proceeds to give the salient provisions of this statute (Rec., pp. 4–10). Then the bill avers that the defendant comes within the provisions of this law. In order to comply therewith the Company must (*a*) make the returns provided for therein; (*b*) pay a normal tax of one per cent. upon its net income; (*c*) deduct and withhold the normal income tax of one per cent. on all coupons and interest on its outstanding bonds with respect to every individual either a holder or owner of coupons or entitled to interest on bonds, who may not have filed with the defendant notice of claim to the exemption of $3,000 or $4,000, allowed by the statute, and (*d*) pay to the Government the tax of individuals so deducted and withheld (Rec., p. 10).

The bill then avers that the defendant, and its directors controlling its affairs, intend voluntarily in the future from year to year, to comply with the provisions of the Statute in the following respects:

(*a*) It will make returns of net income and pay taxes imposed upon its net income;

(*b*) It will deduct and withhold the normal tax upon coupons and interest paid to individuals who are holders of its coupons or entitled to interest on its bonds;

(*c*) It will make returns to the Government of the taxes so deducted and withheld;

(*d*) It will pay these taxes to the Government;

(*e*) It will return to the Government its net income for the ten months of the year 1913 from March 1, 1913, to January 1, 1914;

(*f*) It will pay such tax upon its net income for said period of ten months as may be imposed thereon by the Commissioner of Internal Revenue (which tax will greatly exceed the sum of $3,000);

(*g*) It will return the amounts of the normal income tax deducted and withheld by it upon coupons and interest heretofore paid by individuals who have not claimed the exemption of $3,000–$4,000.

(*h*) It will pay over the normal income taxes so deducted and withheld to the Collector.

The bill then states that unless restrained by injunction, the defendant will (*a*) on or before June 30, 1914, pay such income tax as may be assessed against it for the ten months of the year 1913; (*b*) on or before June 30, 1914, pay the normal income tax of 1 per cent. deducted and withheld upon coupons and interest paid to individuals who have not claimed the exemption of $3,000–$4,000; (*c*) in ensuing years, make such returns and deduct and withhold and pay such taxes as the provisions of the statute purport to require (Rec., pp. 10–11).

The bill then proceeds to analyze this statute in the light of its validity under the constitutional limitations imposed upon Congress (Rec., pp. 11–24). It then concludes that the provisions of this act constitute one entire independent system of taxation; and that, inasmuch as the provisions which have been referred to are unconstitutional and void, the statute is in all respects unconstitutional and void, and any tax which may be levied thereunder upon the

defendant is and will be unconstitutional in every respect (Rec., p. 24).

The bill alleges that the suit is not collusive. It shows that due demand was made by the plaintiff upon the Company's board of directors that the Company should refuse to comply with the provisions of said act, and should take such action as might be necessary to test its constitutionality and that this demand was wholly refused. The bill further says that it will be impossible to have this action of the board of directors reviewed by the stockholders of the Company, because the next meeting of the stockholders would not take place until late in the year 1914, before which time the threatened action of the Company with respect to taxes imposed for the year 1913 would be consummated; and that a special meeting of the stockholders can only be had by order of the board of directors or the executive committee, or by written application of stockholders owning not less than one-third in amount of the capital stock. In view of the position taken by the defendant's executive committee, it would be useless to apply to it or to the board to call a special meeting; and in view of the large number of stockholders and the necessity of publication of notice of a special meeting for three weeks, it would be impossible to obtain the co-operation of a sufficient number of stockholders and the publication of notice within any reasonable time (Rec., pp. 24–5).

The bill then avers that the making of these returns, and payment of the taxes, will result in a great diversion and misappropriation of the corporate assets, and lessen and diminish the interest of the shareholders in the corporation, that unless injunctive relief is granted, the defendant will pay taxes for 1913 and each year in the future, and will also lose the taxes unnecessarily paid in behalf of its bondholders; or the Company will be put to great expense to ascertain which of its bondholders are

exempt from the statute's operation, and to bring numerous suits against the officers of the Government to recover back the taxes thus paid. It is alleged that in any such suits the issues to be determined would involve the same issues offered by this bill, and that issues can be determined more speedily and conveniently in the present action, and the granting of the relief will prevent a multiplicity of suits (Rec., pp. 25–6).

The amount of taxes upon the defendant's income for 1913 exceeds $300,000. The taxes already deducted by the company on account of its bondholders' income, who have not claimed exemption, and with respect to whom the defendant has covenanted to pay taxes required to be withheld, amount to over $6,000.

The bill then avers that the plaintiff has no adequate remedy at law; states that it is filed in behalf of the plaintiff and all other stockholders who may contribute, and prays for the following relief:

(1) That the provisions of the income tax law relating to making returns of net income and payment of taxes imposed upon the net income of corporations, particularly with respect to the period from March 1, 1913, to October 3d, 1913, be adjudged unconstitutional, so far as any tax is sought to be imposed thereby upon the corporate defendant.

(2) That the defendant be enjoined from making a return of its net income or paying any tax thereon, particularly for the said period from March 1, 1913, to October 3, 1913, or from paying any taxes upon income received as dividends upon the stocks of corporations held by it which are subject to taxation upon their incomes under said Act.

(3) That the provisions relating to deduction at the source of taxes upon the income of the Com-

pany's bondholders and making returns and paying such taxes be declared unconstitutional.

(4) That the defendant be enjoined from making any return of taxes upon its coupons or registered interest relating to its outstanding mortgage bonds, or deducting or withholding any such tax, or from paying the same to any collector.

(5) For a temporary injunction to the same effect.

The defendant demurred to the bill upon the ground that Section 2 of said Act was in all respects constitutional and valid (Rec., p. 30) and the Court sustained the demurrer and dismissed the bill on that ground (Rec., p. 31).

Specification of Errors.

The appellant presents the following assignment of errors upon which he relies upon this appeal (Rec., pp. 32–3).

First: That the Court erred in adjudging that section 2 of the Act of the first session of the Sixty-third Congress, which became a law on October 3rd, 1913, generally known as the Tariff Act, is constitutional and valid and that said section was not violative of the third clause of the second section of Article I and the fourth clause of the ninth section of Article I and the first clause of the eighth section of Article I and the implied limitations and restrictions upon the taxing power of the United States contained in the Constitution of the United States and of Article V of the amendments to the Constitution of the United States.

Second: That the Court erred in adjudging that the provisions of section 2 of the Act hereinabove

referred to relating to making returns of net income and payment of taxes imposed upon the net income of corporations, so far as any tax is sought to be imposed thereby upon the property of the defendant Union Pacific Railway Company by reason of the receipt of income prior to October 3rd, 1913, are constitutional and valid.

Third: That the Court erred in adjudging that the provisions of section 2 of the Act hereinabove referred to purporting to impose upon the Union Pacific Railroad Company the duty of deducting and withholding taxes upon income of individuals arising or accruing from coupons or registered interest and making returns and payments to Collectors of Internal Revenue with respect to such amounts so withheld, are constitutional and valid.

Fourth: That the Court erred in adjudging that the provisions of section 2 of the Act hereinabove referred to relating to making returns of net income and payment of taxes imposed upon the net income of corporations, so far as a tax is sought to be imposed upon the income of the defendant Union Pacific Railway Company received as dividends upon the stocks of corporations held by it which were also subject to taxation upon their net income under said Act, are constitutional and valid.

Fifth: That the Court erred in not decreeing that the complainant was entitled to the relief prayed for, or some part thereof.

Sixth: That the Court erred in dismissing the bill of complaint, with costs.

POINT FIRST.

The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the States, in its application to a general and uniform tax upon incomes from whatever source derived. The Income Tax Law of 1913, except in so far as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.

Not only the language of the Sixteenth Amendment, but judicial history leading up to its passage, clearly shows its purpose and the construction which should be placed upon it.

Article 1, Section 2, Subdivision 3 of the Constitution provides:

> "Representatives and direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three-fifths of all other persons."

Article 1, section 9, subdivision 4 provides:

> "No capitation or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken."

A census was provided for within three years from the first meeting of Congress, and thereafter every ten years.

It is part of the history of the Constitution, generally known and recognized, that the purpose of

the provision just quoted was to prevent Congress from imposing a direct tax which would constitute a disproportionate burden on any part of the Union.

Scholey vs. *Rew*, 23 Wall. 331.
Ward vs. *Maryland*, 12 Wall. 418.

Congress, in 1894, adopted an Act entitled "An Act to reduce taxation, to provide revenue for the government and for other purposes," by which a general and uniform tax was imposed upon all incomes from whatever source derived, accrued or received after January 1, 1895, and exceeding four thousand dollars in any year, for each taxpayer or group of taxpayers constituting one family.

In *Pollock* v. *Farmers Loan & Trust Co.*, 158 U. S. 601, this Court, in declaring the Act of 1894 to be unconstitutional, construed the above-quoted clauses of the Constitution as ordaining that no direct taxes could be levied unless in proportion to the enumeration; and held that a tax on income, whether from real or personal property, is a direct tax upon the property from which the income is derived.

It was these constitutional provisions which, prior to 1913, stood in the way of *any* income tax imposed without apportionment.

The Sixteenth Amendment, ratified March 1, 1913, provided:

> "The Congress shall have power to lay and collect taxes on incomes from whatever source derived without apportionment among the several States and without regard to any census or enumeration."

The evident purpose of this amendment was not to abandon the former policy of safeguarding the several sections of the Union against disproportionate taxation, but merely to substitute an apportionment according to "incomes from whatever

source derived," in lieu of a *per capita* apportionment.

The utmost care was used and the clearest intention displayed to remove the necessity for a *per capita* apportionment; but there is no evidence of an intention to change the spirit or effect of the Constitution in any other respect. The expression of the purpose to abrogate merely the one limitation excludes the implication of a purpose to affect any others. The income tax contemplated by the amendment is, accordingly, an income tax preserving in all respects rights secured by the Constitution, but freed from the necessity of *per capita* apportionment. Congress, when it came to legislate on the subject, found its powers in no wise broadened by this amendment save in the one respect mentioned.

Construction of the Amendment.

Obviously, it was not in favor of any and every piece of legislation which Congress might choose to call an income tax, that the Amendment was intended to operate, but only in favor of a "tax on incomes from whatever source derived," according to the fair and natural import of those words and the sense in which they would ordinarily be understood by the people who through their lawful representatives adopted the Amendment. From this it follows, as we contend, that the Sixteenth Amendment has no application, for example, to

(*a*) A tax upon incomes artificially created by statutory definition, but only to a tax on true net incomes coming fairly within the meaning of the word as commonly used and understood at the time when the Amendment was adopted and ratified.

(*b*) A tax upon a specific kind of property, measured by income; as, for example, a tax of ten per cent. on the income of all gold mines in the United States.

(*c*) A tax on a particular form or mode of ownership of property, measured by income, as, for example, a tax on rents or on the profits of leasehold estates.

(*d*) A tax upon a specific class of persons, measured by income; as, for example, a tax of ten per cent. on the income of all unmarried men.

(*e*) A tax upon money or property which is not income at the time when it is taxed although it may have been received as income at some prior period.

(*f*) A tax in the form of forced labor in making deductions and payments out of the income of others, not resting upon any principle of classification or other method of distributing the burden, except the convenience of the government.

As bearing upon the construction of the Sixteenth Amendment in the application to such problems, the fundamental thought which we desire to present is that it was not the intention of those who adopted and ratified that Amendment, nor is it fairly within the language of the Amendment, to invest Congress with a power of regulation and control, by means of discriminating taxes, over all the activities of life which involve the production of income, or over all the details of existence on the part of those who receive income; but only to strengthen the powers of Congress in respect to the production of revenue, by substituting one safeguard in lieu of another, as a protection against oppressive treatment of any section or part of the Union.

The requirement of generality and uniformity is inherent in the language of the Amendment. The law to which the Amendment is by its terms appli-

cable is one taxing *incomes only.* A law which places the burden of taxation partly on incomes because they are incomes and partly upon specific kinds of property or forms or modes of ownership of property or other sources of income is not a tax on incomes pure and simple such as the Sixteenth Amendment contemplates; and, therefore, to the extent to which it involves direct taxation, it can be justified, if at all, only upon some ground other than that afforded by the Sixteenth Amendment. In determining on what the tax rests, it is the incident or quality which draws down the burden of taxation which must be considered. If upon a general income tax law there has been engrafted a provision that the income from sugar plantations shall be taxed at the rate equal to four times the normal tax, the provision for the additional rate, according to the ordinary use of language and the ordinary current of thought, does not constitute a tax upon income, but a tax upon sugar plantations. It is the character of the source of income and not the mere fact of the receipt of income that draws down that part of the burden. Likewise, if there were engrafted upon a general income tax law a provision that the income from real property not occupied by the owner should be taxed at four times the normal rate, such additional provision would not be in substance and truth a tax upon income, but, to the extent of the additional burden of three per cent., it would be a tax upon the relation of landlord and tenant—that is to say, upon a form or mode of holding and using property, deriving its authority wholly from State laws and exempt from the control of the National Government under the general system or the distribution of governmental powers embodied in the Constitution. Discriminations, inequalities, exemptions and artificial rules of computation are excluded from any income tax law which purports to derive its authority from the Sixteenth Amendment, because

they necessarily involve the taxing of something other than income, whereas the evident purpose of the Amendment is to relax the constitutional requirements designed to protect the various sections of the community against oppressive and disproportionate taxation only in favor of a general and uniform tax on net incomes for the purpose of revenue only, which, by its inherent nature, would necessarily serve substantially the same purpose as the constitutional provisions which were relaxed in its favor.

Manner and order of presenting specific questions.

In the subsequent points of this brief and the briefs filed in the two cases which are to be argued simultaneously herewith, it is argued that the Income Tax Law of 1913, in many respects, goes beyond the constitutional limits of the taxing power of Congress and particularly that it imposes direct taxes without apportionment in cases not coming fairly within the spirit and letter of the Sixteenth Amendment. The specific objections to the act are discussed at length only in the particular cases where they have a direct and material bearing upon the rights and interests of the several appellants before the Court. No objection is urged unless it is applicable to a concrete case presented by the pleadings. The grounds of objection discussed in these three cases by no means exhaust the list of those to which the Act is fairly subject. In the bill in the *Brushaber* case (Rec., pp. 13–23) many others are suggested, but it is considered that the fundamental principles involved in the discussion will be adequately presented for decision, by keeping these briefs within the limitations above stated.

Comparison of Present Income Tax Law with prior Laws.

In respect to discriminations, inequalities, artificial definitions and indirect penalties having no relation to the production of revenue, the present Income Tax law not only goes far beyond any of the former laws passed by Congress but beyond any precedent to be found in the whole history of financial legislation. Even the laws passed during the period of the Civil War, when the constitutional limits upon the powers of Congress were poorly defined and patriotic reasons led to general acquiescence in any measures deemed necessary to sustain the public credit, contained fewer objectionable features than are found in this law of 1913. The Act of 5 August, 1861, placed a tax of 3 per cent. on incomes generally with an exemption of $800, but it was in no respect retroactive, contained no provision in regard to collection at the source, and provided for no surtax. The Act of 1 July, 1862, contained no retroactive feature, but provided for a surtax, and in placing a tax upon certain corporations authorized them to deduct the tax from payments made on account of dividends to other parties, and also provided that there should be deducted by the paymasters and all disbursing officers of the United States Government a tax levied upon all salaries of officers or payments to persons in the civil, military, naval or other employment or service of the United States, including senators and representatives and delegates in Congress. The Act of 30 June, 1864, placed a tax on incomes for the year ending the 31st of December following, provided for partial collection at the source, dividends being taxed in the hands of certain corporations and the stockholders permitted to deduct the amount from their estimates. The tax was 5 per cent. on incomes in excess of $600 and not exceeding $5,000, 7-1/2 per cent. on incomes in excess

of $5,000 and not exceeding $10,000, and 10 per cent. on incomes in excess of $10,000.

The Joint Resolution of 4 July, 1864, levied a special income tax "for the year ending the 31st day of December next preceding the time herein named." The Act of 14 July, 1870, contained a provision in regard to deduction at source by banks and trust companies. It was to be collected only for the years 1870 and 1871.

All of these taxes were direct taxes. No provision was made for apportionment. The entire legislation was unconstitutional.

As Mr. Justice FULLER says in the Pollock case, 157 U. S., at page 573,

> "These acts grew out of the war of the rebellion, and were, to use the language of Mr. Justice Miller, 'part of the system of taxing incomes, earnings and profits adopted during the late war and abandoned as soon after that war was ended as it could be done safely' (Railroad Company *vs.* Collector, 100 U. S. 595, 598)."

The provisions in regard to deduction at the source caused inconvenience and confusion, which only the necessity of raising large amounts of money in a short time seemed to justify. In *Barnes* v. *The Railroads*, 17 Wall. 294, the Court, at page 304, said:

> "Different regulations for the assessment and collection of the income taxes of every kind were prescribed in the prior laws imposing internal revenue duties, but they were not in all respects satisfactory, and many controversies have arisen calling in question the action of the revenue officers in their efforts to enforce the collection of that branch of the public revenue. Contrariety of decision has resulted in some instances, and the Circuit Court has decided in one case that a railroad company could not deduct and withhold the amount of such a tax from a dividend due and payable to a non-resi-

dent alien, the presiding Justice being of the opinion that the language of the prior act did not warrant the conclusion that Congress intended to include such holders of bonds or securities in the category of the persons liable to such an assessment."

The provision in regard to the deduction by federal disbursing officers of the tax from the salaries of all persons in the civil, military, naval or other employment or service of the United States was applied to the salaries of federal judges and was the subject of a letter of protest by Chief Justice TANEY, which letter by order of the Court was entered upon the records of the court on the 10th of March, 1863. It was, however, deemed unpatriotic by the federal judges during the war to resist the collection of the tax (Foster Income Tax, 2d Ed. 1915, pp. 96, 98).

The entire series of income taxes of the period being unconstitutional because not apportioned, the various provisions found in this system of taxation furnish no warrant for the constitutional propriety of similar provisions in the present Act. The present Act is not temporary in character, and no stress of circumstances silences the contention that it should strictly conform to all the constitutional guaranties.

Conclusion.

The conclusion is evident that the income tax now authorized by constitutional amendment to be laid without apportionment must be a true and genuine income tax conforming in extent, method of collection, and classification to the supreme law of the land in every respect except dependence upon enumeration, and that the objections herein urged, had they been valid before the Sixteenth Amendment, have equal virtue now.

In thus insisting that the Sixteenth Amendment be confined in its operation to the real purpose which called it into being we believe that we are seeking to strengthen and not to limit the fiscal powers of Congress. If Congress has the power to engraft upon an income tax law exemptions, discriminations and inequalities or to favor particular sections and interests, the passage of such a law even in times of great national emergency, will be delayed by the struggle for personal and political advantage, and in proportion as such struggles are successful the substance of the law will be weakened, its administration be made more difficult and its revenue-producing power diminished.

If, on the other hand, it is now declared and known that under the operation of the Sixteenth Amendment the only income tax law that can be adopted without apportionment is one which is simple and direct in its methods and general and uniform in its operation, not only will the financial position of the government be strengthened in times of emergency, but the original purpose of the provision requiring apportionment will be preserved and made effective through the automatic operation of the requirement that the tax to be imposed must be a general tax upon "incomes from whatever source derived", merely because they are incomes, and not because of their size or their source or any other quality or incident whatsoever.

POINT SECOND.

So much of the Act of October 3d, 1913, as subjects certain corporate earnings to the normal tax of one per cent. as income of the operating corporation, and again subjects the same earnings to a like tax while in process of distribution to the beneficial owners through the instrumentality of an intermediate corporation, operates as a discrimination in the nature of a penalty on corporations holding stock in other corporations and necessarily conflicts with the right of the several States to determine for themselves the permissible forms and modes of ownership of property.

The general plan of the Income Tax Law is to tax income but once, no matter through what number of hands it may be transmitted for distribution to the beneficial owner. Only in so far as it conforms to this plan can the Act be deemed to constitute a general income tax law such as is contemplated by the Sixteenth Amendment. There have been engrafted upon the Act, however, certain provisions, manifestly having no relation to the production of revenue, which place a special burden upon particular forms or modes of owning property or distributing income. An instance of such a foreign element, separable no doubt from the main body of the Act, is the clause designed to discourage corporations from holding stock in other corporations.

The Act, by Paragraph B, subdivision 1 of Section 2, allows the individual taxpayer a deduction of "the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association or insurance company which is taxable upon its net income as hereinafter provided." There are no similar provisions in regard to the corporate taxpayer, and no similar deduction is allowed to it. The result is that the corporate taxpayer which owns stock in other corporations is subject to a disproportionate burden of taxation in the nature of a penalty based upon a classification which must be regarded as arbitrary because having no relation to any power conferred upon Congress by the Constitution.

The situation cannot be considered to be the result of oversight, for the deduction here denied was expressly allowed to corporations under Section 38 of the "Corporate Tax Law" of August 5th, 1909, and also under Section 28 of the Income Tax Law of 1894.

Concrete operation upon the parties to this cause.

The burden thus imposed bears heavily upon the Union Pacific Railroad Company and upon the rights of the plaintiff. The bill shows that the defendant Railroad Company owns stock of other corporations to the amount of several millions of dollars in value and during the year 1913 received large sums of money as dividends on said stock (Rec., p. 17, fol. 28). As is well known from other records in this Court the Railroad Company is the owner of the entire capital stock amounting to $100,000,000 of the Oregon Short Line Railroad Company which in its turn is the owner (except of 15 shares) of the entire capital stock amounting to $50,000,000 of the Oregon-Washington Railroad and Navigation Company. Both the last-named corporation and the

Oregon Short Line are consolidations of the original corporations by which branches and extensions of the Union Pacific system were constructed, the use of separate subsidiary corporations for that purpose being compelled by financial reasons. The growth of every great railroad system in the country shows the same history. Without the gradual amalgamating instrumentalities of leases, stock-ownership, divisional mortgages and mergers, those systems would not have been formed so rapidly or along such natural lines.

The Union Pacific Railroad Company is also, as the records show, the owner of stock in a fruit express company, an equipment association and various other corporations engaged in business other than railroad business, but incidental thereto. The effect of the discrimination against corporations holding stock in other corporations contained in the Act of 1913, is in substance to compel the Union Pacific Railroad Company to pay the tax three times upon income derived through the instrumentality of the Oregon-Washington Railroad and Navigation Company, and twice in the case of income derived through the other controlled corporations.

It will scarcely be contended that Congress has general power to regulate the form or mode of ownership of property within the several states. Still less has Congress the power to impose a direct tax upon property, without apportionment, because of the form or mode of ownership. The public policy of the several states upon the subject in question is not uniform. In all the States the ownership by railroad companies of the stock of other railroad companies, not having parallel or competing lines, is permitted or encouraged. In some states railroad companies, while permitted to own stock in manufacturing and mining corporations producing materials suitable for use in the railroad business, are

not themselves permitted to engage in any business other than that of transportation. In other states a different policy prevails. Except as interstate commerce may be directly affected, the general theory of the distribution of governmental powers embodied in the constitution requires that the several States should have full power to give effect to their own views of public policy in such matters within their own borders. One of the most important questions presented by this case is whether Congress can substitute its own judgment upon such questions for that of the states responsible for the creation and regulation of the corporations affected, under the guise of a classification of corporations, based upon differences entirely unrelated to any power or function given to the Federal Government by the Constitution.

The Union Pacific Railroad Company, like most other railroad companies, is invested by the State of its creation with the franchise to own and manage its property and to develop its system and enlarge its facilities according to the methods which experience has shown to be best adapted to that end, including the construction of branches and extensions and the provision of new facilities and equipment by means of separate subsidiary corporations, for the purpose among other things of convenient financing. Congress assumes by the Act of 1913 to divide such corporations into two classes, those which do and those which do not exercise, in the particular mode here under discussion, the franchises given them by the State of their creation for the more effective accomplishment of their corporate purposes. A special and additional tax in the nature of an excrescence upon the general system for the taxation of incomes is imposed upon those who exercise fully the franchises given to them, as it must be assumed, in furtherance of the public policy of the State. This, we submit, is not reasonable classification.

Limitations upon the power of classification possessed by Congress.

The power to make laws and impose taxes is a sovereign power and must be exercised with due regard to the nature and limitations of the sovereignty. Where sovereignty is divided, as it is under our form of government, the reasonableness or unreasonableness of classification depends somewhat on the scope and character of the general legislative power which is being exercised. A State having plenary authority over the details of domestic life may make classifications which would be out of place in an act of Congress. Classification which would be approved in a tax law might be thought arbitrary in a statute passed in the exercise of the police power. A State which should classify merchants for the purpose of taxation, according as they did or did not exercise the privilege given by Congress of distributing their merchandise through the mails, or the privilege of engaging in interstate commerce, would clearly be making a classification based upon matters outside the scope of its sovereignty (*Guy* vs. *Baltimore*, 100 U. S. 434). The same classification made by Congress might perhaps be held to be within its power.

So we contend here that Congress in classifying corporations for the purpose of taxation, according to their plan or mode of owning property within State boundaries and under State-given franchises, is attempting a classification based upon a matter outside the scope of its sovereignty, and is, moreover, going far outside the scope of a general and uniform income tax law such as was contemplated by the Sixteenth Amendment.

In this connection a distinction should be observed between the primary powers of Congress over matters in respect to which plenary jurisdiction is given by the Constitution and the secondary or ancillary

powers, not exclusive in their nature, which can be exercised only to the extent that they are necessary or appropriate in aid of the primary powers.

The power of Congress over foreign commerce is a primary power. It may prohibit such commerce altogether or may regulate it or convert it into a source of revenue according to any method or principle of classification, not purely arbitrary, which it sees fit to adopt. The same may be said of the power over the postal service or over interstate commerce or over the public lands. For this reason tariff laws must be looked upon with caution when they are referred to as precedents in other fields of tax legislation.

Congress also has power to provide for the administration of oaths and the examination of witnesses, but this is not a primary power. It can be exercised only as an incident to some exercise of jurisdiction flowing from the existence of one or more of the primary powers (*Kilbourn* vs. *Thompson*, 103 U. S. 168; *In re Chapman*, 166 U. S. 661). Likewise Congress has power to define crimes and provide for their punishment, but this also is an ancillary, not a primary power (*U. S.* vs. *Fox*, 95 U. S. 670; *U. S.* vs. *Harris*, 106 U. S. 629). In *U. S.* vs. *Fox* (*supra*) Mr. Justice FIELD delivering the unanimous opinion of the Court said (p. 672):

> "Any act committed with a view of evading the legislation of Congress passed in the execution of any of its powers, or of fraudulently securing the benefit of such legislation may properly be made an offense against the United States. But an act committed within a State, whether for a good or a bad purpose, or whether with an honest or a criminal intent, cannot be made an offense against the United States, unless it have some relation to the execution of a power of Congress, or to some matter within the jurisdiction of the United States. An act not having any such relation is one in respect to which the State can alone legislate."

Congress has the power to tax and it is a very important power, but it is not a primary power. It is not plenary and exclusive like the power over foreign commerce. The production of revenue is a purpose of such urgent necessity that any feature of a tax law that is adapted to that end, and is not at variance with any express constitutional limitation, must be deemed valid. Discriminations, exemptions and inequalities, however, have no presumptive relation to the production of revenue; they diminish rather than increase the effectiveness of the law as a fiscal measure and, if justified at all, must be justified because of their relation to some other matter within the jurisdiction of the sovereignty which makes the law, to which the taxing power may properly be adapted and made subservient.

All these considerations lead to two conclusions:

(1) The classification of the subjects of taxation contained in any tax law, in order to be valid, must be based on differences having a reasonable relation to some field of jurisdiction of the authority which imposes the tax.

(2) The classification of the subjects of taxation in an income tax law, in order that such law may be entitled to the benefit of the Sixteenth Amendment, must have a reasonable relation to the production of revenue from incomes without regard to source.

Holding stock in other corporations is not a legitimate basis of classification in a federal tax law.

That the provisions of the Act of 1913, here under discussion, will meet neither of these tests is immediately apparent. There is no basis whatever for the classification found in the Act other than a certain prejudice which is in the air against holding companies. By a holding company we

understand a corporation which has as its main excuse for existence the holding of stock in other corporations. Because some corporations which hold stock in other corporations are holding companies, therefore this Act imposes a disproportionate tax on all corporations so situated, although the general question whether a corporation chartered by a State shall or shall not be permitted to hold the stock of another corporation is admittedly beyond the jurisdiction of Congress.

This legislative disapproval of holding companies is shown in other parts of the Act. Subdivision 2 of Section 11 provides for two cases of presumed fraudulent purpose to escape the tax: where gains and profits are permitted to accumulate beyond the reasonable needs of the business, such accumulation being certified as unreasonable by the Secretary of the Treasury, and where the corporation, joint stock company or association *is a mere holding company*. In other words, a mere holding company is for the reason alone that it is such, presumed to be fraudulent in purpose.

A more flagrant instance of arbitrariness in the exercise of the taxing power could hardly be imagined. Dividends upon stock owned by an individual are taxed once when the earnings of the corporation are taxed and they are not taxed again. The same dividends, when the stock is held by a corporation, are taxed twice; once when the earnings of the corporation issuing the stock are taxed, and a second time when the earnings of the corporation owning the stock are taxed. A certain class of owners is singled out for special burden for no other reason than the disapproval of Congress in respect to the method used in holding title to their property.

It is obvious that this process of taxing the same amount of money over and over again would be repeated as often as the original dividend of the first

corporation issuing stock passed along through different holding companies and was represented in the earnings of those companies. The same amount of money would be taxed as many times as it passed from one holding company to another, and the process of taxing it would not cease until the amount of the first dividend finally reached the hands of individual owners of the capital stock of the last holding company. In the case of the Union Pacific Railroad Company this process results in taxing *three times* the earnings of a corporation having a capital stock of $50,000,000. There is no reasonable ground of classification for the purpose of taxation between an individual as owner of stock of a corporation and a corporation as owner of the stock of another corporation. To uphold such a discrimination would be to construe the Sixteenth Amendment as giving Congress the power to tax incomes at different rates according to the sources that produced the income. This is precisely the power that Congress has sought to exercise in creating this discrimination between individuals and corporations as the owners of corporate stock. The income of an individual when composed of dividends of corporations is not subject to the normal tax. The earnings of corporations when composed of dividends of corporations are subject to the normal tax. This discrimination cannot be upheld on the ground that it is an excise tax upon corporations for or by reason of doing business in a corporate capacity, for the burden does not fall upon all corporations or upon those doing certain kinds of business. Nor is it confined to corporations which do business at all. It is a burden placed directly upon a feature of corporate existence which is *distinct from the doing of business* (*McCoach* vs. *Minehill Railway Co.*, 228 U. S. 295).

Authorities condemning arbitrary selection under the guise of classification.

In *County of Santa Clara* v. *Southern Pacific R. Co.*, 18 Fed. 385 (affirmed 118 U. S. 394), Justice FIELD held that a tax law which discriminates between the assessment for taxation of the property of a corporation and of the property of individuals, giving individuals an exemption not granted to the corporation, was unconstitutional. The Act therein concerned declared that a mortgage, deed of trust, contract or other obligation should for the purposes of assessment and taxation be deemed an interest in the property affected thereby, and provided:

> "*Except as to railroad and other quasi public corporations* in case of debts so secured, the value of the property affected by such mortgage, deed of trust, contract or obligation, less the value of such security, shall be assessed and taxed to the owner of the property and the value of such security shall be assessed and taxed to the owner thereof."

Justice FIELD at page 394 said:

> "Instances of every day occurrence will show the effect of this discrimination in a clear light. A natural person and a railroad company own together a parcel of property in equal proportions subject to a mortgage. In estimating the value of the undivided half belonging to the natural person, half of the amount of the mortgage is deducted. In estimating the value of the undivided half belonging to the railroad company, no part of the mortgage is deducted. The discrimination is made against the company for no other reason than its ownership. * * * Everyone sees that the valuation has not in fact changed with the ownership and therefore that the discrimination is made solely because a rule is adopted in the assessment of the property of one party different from that applied in the assessment of the property of the other, purely on

account of its ownership. A corresponding difference in the tax which the different owners must pay follows the assessment. Thus, if two adjoining tracts are subject to a mortgage, each for half its value, the natural person owning one of them pays a tax on the other half, while the corporation must pay a tax on the whole of its tract; that is, double the tax of the individual. * * *

"The principle which sanctions the elimination of one element in assessing the value of property held by one party, and takes it into consideration in assessing the value of property held by another party, would sanction the assessment of the property of one at less than its value,—at a half or a quarter of it,—and the property of another at more than its value,—at double or treble of it,—according to the will or caprice of the state. To-day railroad companies are under its ban, and the discrimination is against their property. To-morrow it may be that other institutions will incur its displeasure. If the property of railroad companies may be thus sought out and subjected to discriminating taxation, so, at the will of the state, by a change of its constitution, may the property of churches, of universities, of asylums, of savings banks, of insurance companies, of rolling and flouring mill companies, of mining companies, indeed, of any corporate companies existing in the state. The principle which justifies such a discrimination in assessment and taxation, where one of the owners is a railroad corporation and the other a natural person, would also sustain it where both owners are natural persons. A mere change in the state constitution would effect this if the federal constitution does not forbid it. Any difference between the owners, whether of age, color, race, or sex, which the state might designate, would be a sufficient reason for the discrimination. It would be a singular comment upon the weakness and character of our republican institutions if the valuation and consequent taxation of property could vary according as the owner is white, or

> black, or yellow, or old, or young, or male, or female. A classification of values for taxation upon any such ground would be abhorrent to all notions of equality of right among men. Strangely, indeed, would the law sound in case it read that in the assessment and taxation of property a deduction should be made for the mortgages thereon if the property be owned by white men or by old men, and not deducted if owned by black men or by young men; deducted if owned by landsmen, not deducted if owned by sailors; deducted if owned by married men, not deducted if owned by bachelors; deducted if owned by men doing business alone, not deducted if owned by men doing business in partnerships or other associations; deducted if owned by trading corporations, not deducted if owned by churches or universities; and so on, making a discrimination whenever there was any difference in the character or pursuit or condition of the owner. To levy taxes upon a valuation of property thus made is of the very essence of tyranny, and has never been done except by bad governments in evil times, exercising arbitrary and despotic power."

When the case came before this Court (118 U. S. 394) the Court at page 410 stated that the importance of the constitutional questions could not well be overestimated but that they belonged to a class which the Court should not decide unless essential to the disposition of the case. This Court thereupon affirmed on the ground that the entire assessment was a nullity.

The same question was before this Court in *San Bernardino Co.* v. *Southern Pacific R. R. Co.*, 118 U. S. 417. Justice FIELD concurring stated that he regretted that it had not been deemed consistent with the duty of the Court to decide the important constitutional questions involved, and at page 422 stated:

> "At the present day nearly all great enterprises are conducted by corporations. Hardly

an industry can be named that is not in some way promoted by them and a vast portion of the wealth of the country is in their hands. It is therefore of the greatest interest to them whether their property is subject to the same rules of assessment and taxation as like property of natural persons, or whether elements which affect the valuation of property are to be omitted from consideration when it is owned by them and considered when it is owned by natural persons; and thus the valuation of property be made to vary not according to its condition or use but according to its ownership. The question is not whether the state may not claim for grants of privileges and franchises a fixed sum per year or a percentage of earnings of a corporation—that is not controverted—but whether it may prescribe rules for the valuation of property for taxation which will vary according as it is held by individuals or by corporations. The question is of transcendent importance and it will come here and continue to come until it is authoritatively decided in harmony with the great constitutional amendment which insures to every person whatever his position or association, the equal protection of the laws; and that necessarily implies freedom from the imposition of unequal burdens under the same conditions."

In *County of San Mateo* v. *Southern Pacific R. Co.*, 13 Fed. 145, the case had been removed to the Federal Court, and the opinion was written on a motion to remand. Justice FIELD stated that the rule of equality necessitated by the Fourteenth Amendment had been recognized by Congress as applicable to federal taxation, at page 150 saying:

"Equality of protection is thus made the constitutional right of every person; and this equality of protection implies not only that the same legal remedies shall be afforded to him for the prevention or redress of wrongs and the enforcement of rights, but also that he shall be subjected to no greater burdens or charges than

such as are equally imposed upon all others under like circumstances. No one can, therefore, be arbitrarily taxed upon his property at a different rate from that imposed upon similar property of others, similarly situated, and thus made to bear an unequal share of the public burdens. Property may indeed be classified, and different kinds be subjected to different rates. Real property may be taxed at one rate and personal property at another. Property in particular places may be taxed for local purposes, while property situated elsewhere is exempt. License taxes may also vary in amount, according to the calling or business for which they are exacted. But arbitrary distinctions not arising from real differences in the character or situation of the property, or which do not operate alike upon all property of the same kind similarly situated, are forbidden by the amendment Equality in the imposition of burdens is the constitutional rule as applied to the property of individuals, where it is subject to taxation at all; and this imports that an uniform mode shall be followed in the estimate of its value, and that the contribution exacted shall be in some uniform proportion to such value prescribed, according to the nature or position of the property. All state action, constitutional or legislative, impinging upon the enforcement of this rule, must give way before it. Congress, in its legislation since the adoption of the amendment, has recognized this to be the rule. The amendment was adopted in 1868, and in 1870 Congress re enacted the civil rights act; and to the clause that all persons within the jurisdiction of the United States should enjoy the same rights as white citizens, and be subject only to like punishment, pains, and penalties, it added; and be subject only to like '*taxes, licenses, and exactions of every kind, and to no other.*' Rev. St. Sec. 1977."

The idea of uniformity enters into the very definition of a tax. Cooley on Taxation, 3rd Edition, Volume 1, page 1, says:

"Taxes are the enforced *proportional* contributions from persons and property levied by

the State by virtue of its sovereignty for the support of government and for all public needs."

And at page 4:

"They differ from the enforced contributions, loans and benevolencies of arbitrary and tyrannical periods in that they are levied by authority of law and *by some rule of proportion which is intended to insure uniformity of contribution and a just apportionment of the burdens of government.*"

Under our form of government this is an essential feature of taxation and constitutes a limitation upon the power of Congress.

Gray, Limitations on Taxing Power, page 353:

"The view established by authority is that the words as used in the Constitution refer to *geographical uniformity.* It is not intended by this to say that Congress can lay indirect taxes violative of all the principles of equality and uniformity as between persons. Congress *is* limited in this regard; but its limitations are derived not from the words 'uniform throughout the United States,' but from the general nature of all legislative power to tax from the inherent elements of uniformity and equality which partly make up the concepts of taxation and taxes. The restrictions upon Congress in this regard arise from the very nature of legislative power as a power held in trust for the whole people."

Cooley, Constitutional Limitations, pp. 607, 615:

"In the second place it is of the very essence of taxation that it be levied with equality and uniformity and to this end that there should be some system of apportionment. Where the burden is common, there should be a common contribution to discharge it. Taxation is the equivalent for the protection which the government affords to the persons and property of its citizens; and as all are alike protected, so all

> alike should bear the burden. * * * Whatever may be the basis of taxation, the requirement that it shall be uniform is universal."

This principle has been many times recognized in this Court.

In *Loan Assn.* v. *Topeka*, 20 Wall. 655, Mr. Justice MILLER at page 663 said:

> "The theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere. The executive, the legislative and the judicial branches of these governments are all of limited and defined powers.
>
> "There are limitations on such power which grow out of the essential nature of all free governments,—implied reservations of individual rights without which the social compact *could not exist* and which are respected by all governments entitled to the name."

In *United States* v. *Singer*, 15 Wall. 111, the Court at page 121 said:

> "The tax imposed upon the distiller is in the nature of an excise and the only limitation upon the power of Congress in the imposition of taxes of this character is that they shall be 'uniform throughout the United States.'".

In *M'Culloch* v. *Maryland*, 4 Wheat. 316, Mr. Chief Justice MARSHALL at page 435 said:

> "The people of all the states, and the states themselves, are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the states, they tax their constituents, *and these taxes must be uniform.*"

In *Ward* v. *Maryland*, 12 Wall. 418, Mr. Justice CLIFFORD at page 431 said:

> "Inequality of burden as well as the want of uniformity in commercial regulations was

> one of the grievances of the citizens under the Confederation; and the new Constitution was adopted among other things to remedy those defects in the prior system."

In *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, it was contended that the statute was void for lack of uniformity. The Court summarizing the contention at page 555 said:

> "Under the second head it is contended that the rule of uniformity is violated in that the law taxes the income of certain corporations, companies and associations, no matter how created or organized at a higher rate than the incomes of individuals or partnerships derived from precisely similar property or business. * * * These and other exemptions being alleged to be purely arbitrary and capricious, justified by no public purpose and of such magnitude as to invalidate the entire enactment."

Counsel for all parties including the Attorney General agreed that Congress was limited in its power of taxation to a certain degree of equality and uniformity, that prevented oppressive discrimination against members of the same class with those more favored.

The Court at page 586 stated that inasmuch as the Justices who heard the argument were equally divided upon the question whether the tax was invalid for want of uniformity, no opinion was expressed on that subject. Mr. Justice FIELD, however, in his concurring opinion at page 591 said:

> "The object of this provision (of uniformity) was to prevent unjust discriminations. It prevents property from being classified and taxed as classed, by different rules. All kinds of property must be taxed uniformly or be entirely exempt. The uniformity must be co-extensive with the territory to which the tax applies. Mr. Justice MILLER in his lectures on the Constitution (N. Y. 1891), pages 240,

241, said of taxes levied by Congress: 'The tax must be uniform on the *particular article;* and it is uniform within the meaning of the Constitutional requirement if it is made to bear the *same percentage* over all the United States. That is manifestly the meaning of this word as used in this clause. The framers of the Constitution could not have meant to say that the 'government in raising its revenues should not be allowed to discriminate between the articles which it should tax.' In discussing generally the requirement of uniformity found in state constitutions, he said: 'The difficulties in the way of this construction have, however, been very largely obviated by the meaning of the word "Uniform" which has been adopted holding that uniformity must refer to articles of the same class. *That is, different articles may be taxed at different amounts provided the rate is uniform on the same class everywhere with all people and at all times.*'"

And Mr. Justice FIELD at page 599 further said:

"But there are other considerations against the law which are equally decisive. They relate to the uniformity and equality required in all taxation, national and state; to the invalidity of taxation by the United States of the income of the bonds and securities of the States and of their municipal bodies; and the invalidity of the taxation of the salaries of the Judges of the United States Courts.

"As stated by counsel: 'There is no such thing in the theory of our national government as unlimited power of taxation in Congress. There are limitations as he justly observes of the powers arising out of the essential nature of all free governments; there are reservations of individual rights without which society could not exist and which are respected by every government. The right of taxation is subject to these limitations.'"

The dissenting opinion of Mr. Justice BREWER in *Magoun* v. *Illinois Trust & Savings Bank*, 170 U. S.

283, at 301, is particularly applicable to the case at bar. He says:

> "I am unable to concur in the foregoing opinion so far as it sustains the constitutionality of that part of the law which grades the rate of the tax upon legacies to strangers by the amount of such legacies. If this were a question in political economy I should not dissent but it is one of constitutional limitations. Equality in right, in protection and in burden is the thought which runs through the life of this nation and its constitutional enactments from the Declaration of Independence to the present hour. Of course absolute equality is not attainable and the fact that a law, whether tax law or other works inequality in its actual operation does not prove its unconstitutionality (*Merchants Bank* v. *Pennsylvania*, 167 U. S. 461). But when a tax law directly, necessarily and intentionally creates an inequality of burden, it then becomes imperative to inquire whether this inequality thus intentionally created can find any constitutional justification."

In *Southern Railway Company* v. *Greene*, 216 U. S. 400, it was held that a statute which classified separately domestic and foreign corporations for the purpose of taxation and imposed a greater franchise tax upon foreign corporations than that imposed upon domestic corporations was an arbitrary selection and could not be justified by calling it classification in the absence of real distinction of a substantial basis. The Court said:

> "While reasonable classification is permitted without doing violence to the equal protection of the laws, such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed, and classification cannot be arbitrarily made without any substantial basis. Arbitrary selection, it has been said, cannot be justified

by calling it classification." (*Gulf, Colorado & Santa Fe Ry.* v. *Ellis*, 165 U. S. 150, 155, 165; *Cotting* v. *Kansas City Stockyards Co.*, 183 U. S. 79; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 559."

While the case above cited arose under the Fourteenth Amendment to the Constitution of the United States, and while it was held that the complaining corporation was a citizen within the jurisdiction of the State of Alabama and entitled to the equal protection of its laws under that amendment, the case is an additional authority to many in this Court upon the proposition that while a legislative body possesses great powers in classifying subjects of taxation and imposing different rates of taxation upon different classes of subjects, the action of the legislature must be classification and not arbitrary selection. It is well said that the object of the Fourteenth Amendment was "to prevent any person or class of persons from being singled out as a special subject for discriminating and hostile legislation" (*Pembina Mining Co.* v. *Pennsylvania*, 125 U. S. 181, 188), but the principle of the Fourteenth Amendment that prevents this discriminating and hostile legislation is found in the implied limitations of the Constitution of the United States upon the taxing power of Congress. The power that is given to Congress is to levy and collect taxes, and amounts sought to be collected by legislation by the process of arbitrary selection and not by that of classification are not taxes, but arbitrary exactions and beyond the power of Congress to enforce. It has been frequently held that, notwithstanding the language of the Fourteenth Amendment in its guarantee of equal protection of the laws is not to be found in the Constitution of the United States, that its principle is an implied limitation on the powers of Congress, and that the Constitution of the United States by implication requires Congress

to see to it that in its legislation the citizens of the United States receive the equal protection of the laws of the United States.

While it is the function of the Legislature to classify, or to attempt to classify, for purposes of taxation, it is the function of the Court to inquire whether the result attained is classification or arbitary selection. As "such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed and classification cannot be arbitarily made without any substantial basis," in the language of this Court (216 U. S. 417), it is the function of this Court to inquire whether any criticized classification is or is not based upon some real and substantial distinction, and whether such distinction does or does not bear a reasonable and just relation both to the things in respect to which such classification is imposed, and the nature of the legislative power to the exercise of which the classification is incident.

Conclusion.

Corporations, in their relation to income, are mere instrumentalities for getting income together and distributing it among those beneficially interested. On no other theory can the discrimination between corporations and individuals in respect to the surtax be justified. One tax on the income at any stage between its original accrual and final distribution is all that comes within the scope of a general income tax law such as the Sixteenth Amendment contemplates. The additional tax or taxes on income distributed through intermediate corporations, exacted by the Income Tax Law of 1913, are in substance and effect direct taxes upon the property from which the income is derived and therefore void for lack of apportionment. No ques-

tion of excise tax is involved because Congress has not attempted to impose any such tax and because the additional tax by its terms is not limited to corporations which do business in a corporate or organized capacity but extends to those which merely receive and distribute dividends (*McCoach* vs. *Minehill, etc., R. Co.*, 228 U. S. 295). The discrimination of which we complain was in fact aimed at corporations of the type last mentioned and would not have been introduced into the law except for the hostility with which they were regarded.

POINT THIRD.

The provisions of the statute which require collection at the source by corporations, debtors, fiduciaries and employers involve the taking of property without due process of law and the taking of private property for public use without compensation and are invalid.

The act of October 3rd, 1913, provides that all persons, corporations or associations acting in any fiduciary capacity shall make and render a return of the net income of the persons for whom they act coming into their custody or control; that all persons or corporations, in whatever capacity acting, having the receipt or payment of fixed or determinable annual or periodic gains, profits or income of any person subject to the tax shall on behalf of such person deduct and withhold from the payment an amount equivalent to the normal tax upon the same and render a separate

and distinct return of it, which return shall also contain the name and address of the person. They are required to pay the tax to the proper officers of the United States Government and are made personally liable therefor. The tax must be withheld from the income derived from interest upon bonds and mortgages or deeds of trust or similar obligations of corporations *whether payable annually or at shorter or longer periods, although such interest does not amount to three thousand dollars.* A fine and an addition of fifty per cent. to the tax are imposed upon the corporation or person neglecting to perform the above duties.

Paragraph D of Section 2 of the Act of October 3, 1913, contains various provisions with regard to the collection of the tax at the source. The method of such collection is prescribed by the following extract:

> " * * * guardians, trustees, executors, administrators, agents, receivers, conservators and all persons, corporations or associations acting in any fiduciary capacity shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals; * * * and also all persons, firms, companies, copartnerships, corporations, joint stock companies or associations and insurance companies, except as hereinafter provided, in whatever capacity acting, having the control, receipt, disposal or payment of fixed or determinable annual or periodical gains, profits and income of another person, subject to the tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal tax upon the same and make and render a return as aforesaid, but separate and distinct of the portion of the income of each person from which the normal tax has thus been withheld, and containing also the name and address of such person or stating that the name and address, or the ad-

dress, as the case may be, are unknown; * * * *Provided further* that in either case above mentioned no return of income not exceeding $3,000 shall be required:"

Paragraph E of the Act contains the following provision:

"All persons, firms, copartnerships, companies, corporations, joint stock companies or associations and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers and all officers and employees of the United States having the control, receipt, custody, disposal or payment of interest, rent salaries, wages, premiums, annuities, compention, remuneration, emoluments or other fixed or determinable annual gains, profits and income of another person exceeding $3,000 for any taxable year, other than dividends on capital stock or from the net earnings of corporations and joint stock companies or associations, subject to like tax, who are required to make and render a return in behalf of another as provided herein to the collector of his, her or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits and income such sum as will be sufficient to pay the normal tax imposed thereon by this section and shall pay to the officers of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax. * * * *Provided further* that the amount of the normal tax hereinbefore imposed shall be deducted and withheld from fixed and determinable annual gains, profits and income derived from interest upon bonds and mortgages or deeds of trust or similar obligations of corporations, joint stock companies, or associations, and insurance companies, whether payable annually or at shorter or longer periods, although such interest does not amount to $3,000, subject to the provisions

of this section requiring the tax to be withheld at the source and deducted from annual income and paid to the government".

Paragraph F provides:

"F. That if any person, corporation, joint stock company, association or insurance company liable to make the return or pay the tax aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, such person shall be liable to a penalty of not less than $20 or more than $1,000."

Paragraph I provides for the Amendment of Section 3176 of the Revised Statutes of the United States, as amended, so as to include persons, corporations, companies or associations liable to make a return under the Federal Income Tax Act. This section provides that in case of the refusal or neglect, except in cases of sickness or absence, to make a list or return or to verify the same, the Commissioner of Internal Revenue shall add fifty per centum to the amount of the tax found by him upon an examination to be payable.

These provisions of the Act therefore impose upon the persons and corporations against whom the requirement is directed the obligations—

(*a*) To make a "return" to the proper Collector;

(*b*) To withhold the amount of the normal tax upon the payment made by them;

(*c*) To pay the tax so withheld to the proper Collector;

(*d*) Personal liability for the tax; and

(*e*) In the event of their failure "to make the return or pay the tax aforesaid" to pay a penalty of not less than $20 or more than $1,000, and an additional fifty per cent. of the amount of the tax.

These provisions impose upon certain persons and corporations, if they be fiduciaries, employers, tenants, or debtors paying interest periodically upon coupons or registered bonds or notes, onerous duties in regard to the collection and payment of the taxes of other persons. All these classes enumerated, whether they be corporations or individuals, besides paying their own taxes must ascertain which of the various forty-three "forms of return" issued by the United States Treasury Department is applicable, must keep books and accounts from which the details required by the form can be filled in, must prepare, verify and file the different returns after having computed the amount of the tax in each case which must be withheld.

Further, in the event that the beneficiary, employee, landlord or creditor claims the benefit of the statutory exemption of $3,000, or $4,000, a notice to that effect is filed with the fiduciary, employer, tenant or debtor, who then must not withhold the tax and must transmit the claim to exemption to the proper collector of internal revenue.

Concrete effect upon the defendant of provisions for compulsory service.

The bill alleges (Rec., p. 15):

> "Your orator avers, on information and belief, that the annual additional expense of the defendant corporation in connection with the performance of its duties of collection of income tax at the source, which involves the hiring of additional clerks, opening and keeping additional books of record, the making out of many documents and returns, additional bookkeeping, labor of various sorts, correspondence and other matters, will amount to the sum of at least between five and ten thousand dollars. That the purpose of the aforesaid requirements is to assist the Government of the United States in collecting the said income tax and to give to it in-

formation with respect to individuals liable to pay said tax. That compliance with such requirements imposes an additional burden upon this defendant and other corporations over and above the amount of any tax that can be levied and assessed upon them under the terms of said Act, and that the imposition of such burden is contrary to and violative of the Fifth Amendment to the Constitution of the United States and involves the taking of property without due process of law and the taking of private property for public use without compensation."

Invalidity of requirement for compulsory service.

A requirement by statute that services unknown to the common law shall be performed by corporations or citizens without compensation is the equivalent of a statutory requirement, taking arbitrarily and without due process of law and for public use without compensation, the property, real or personal, of the citizens. These propositions become more clear when we consider their application to the case of a corporation, like this defendant, which is incapable of performing services for the State, except through the acts of individuals who are its employees. The corporation which is called upon by the statute in question to perform gratuitous services for the Government in the collection of an income tax, has no means of compelling its individual employees to act in the service of the Government. It can only command those services by pecuniary rewards which deplete its resources. To the extent that the corporation in order to comply with the requirements of the Income Tax Law is forced to compensate its employees and to make other expenditures in the nature of stationery, rent, postage and other matters incidental to the transaction of the Government's business, to that extent the resources of the corporation are depleted and its property is taken for public use without due process of law and without compensation. The vital

question is whether the application by the Income Tax Law of the resources of private corporations, as well as those of fiduciaries, debtors and employers, to the public service and without compensation, is a lawful exercise of the power of taxation. Does the Sixteenth Amendment, in conferring upon Congress the right to tax income from whatever source derived, involve the conclusion that for the purpose of collecting such tax the private property of corporations and individuals can be applied without compensation to the public use? Can the convenience of the Government be made the basis of a classification of persons from whom gratuitous services unknown to the common law and involving the expenditure of money are to be exacted? If so, the way is open to take private property for public use without compensation whenever the convenience of the Government demands it. The effect of the Income Tax Law is to create corporations, debtors, fiduciaries and employers, assessors and collectors of the Income Tax, and not only to require the personal services of individuals but also the expenditure of such amounts of money as are necessarily involved in the performance of those services. Such services are wholly unknown to the common law and form no part of our system of relations between the citizens and our national government in view of the protection afforded by the Constitution of the United States. Corporate fiduciaries especially, acting in many trusts for many beneficiaries, are under the necessity of augmenting their office force. The burden of collecting and paying the taxes of large groups of persons falls directly and finally upon these corporate fiduciaries, for they cannot collect the expense thereof from their beneficiaries, as their compensation is almost universally limited by the state statutes which authorize their appointment.

Similar duties in regard to collecting taxes are

placed upon employers of persons whose individual salaries exceed the sum of three thousand dollars per annum. Perhaps in no case, however, does the oppressiveness of the burden and expense appear more clearly than in the case of corporations having outstanding bonded or other indebtedness upon which interest is paid. Frequently such payments are made through the medium of a fiscal agent—usually a bank or trust company—and in such cases the labor and expense falls upon the fiscal agent as well as upon the debtor corporation. Under the regulations of the Treasury Department the holders of bonds or other evidences of indebtedness are required to attach to their coupons representing the interest payable thereon "certificates of ownership" of prescribed forms. Before paying the interest due the fiscal agent must ascertain that the "certificate" attached is in proper form as required by the Treasury regulations and must determine at its peril whether on the statements made therein the tax should or should not be deducted on the amount of the interest payable. The fiscal agent must regularly report to the debtor corporation the gross amount of the tax withheld and deliver to it the "certificates of ownership." The debtor corporation in turn must make a return to the Collector of Internal Revenue of its district and list each of the "certificates of ownership" received from its fiscal agent, giving the names and addresses of the persons from whom the tax was withheld and of those from whom the tax was not withheld. Such returns are required to be made monthly.

Where the income is derived from interest upon bonds and mortgages or deeds of trust, no matter how small the amount or how often it is payable, if exemption be not claimed, the tax thereon must be deducted and with the prescribed report must be turned over to the government authorities.

This method may succeed in collecting the tax,

but it is obvious that it entails an expense in time and labor upon the third parties, neither taxed nor taxing, which must often exceed the amount realized. The intricate labor of collecting data, rendering reports and turning over multitudinous and frequently small sums of money is performed directly for the benefit of the United States government. The employers, corporations, debtors and fiduciaries are constituted its tax collectors, but far from providing for their reasonable compensation, their labor is enforced under threat of fine and penalty.

Inapplicability of prior decisions regarding collection at the source.

The matter of collection at the source has been treated incidentally in several cases arising out of the previous income tax laws, but in none of these was any constitutional question raised in opposition to the validity of this method of collecting the tax. Examples of such cases are the following:

> *Haight* v. *Railroad Company*, 6 Wall. 15.
> *United States* v. *Railroad Company*, 17 Wall. 322.

An examination of the cases in which the courts have treated this subject discloses that in no case has the complaining corporation found the burden so great as to lead to its resistance of the performance of the duties imposed upon it by Congress upon the grounds herein set forth.

The method is herein objected to in that it necessitates substantial labor and expense for the public benefit without providing any compensation.

It is of course true that this general plan of providing that the tax due by one is to be reported and paid by another is to be found in other statutes and has had the approval of this Court (*National Safe Deposit Company* v. *Stead*, 232 U. S. 58, p. 70).

Applied to certain situations, the plan entails little hardship and any modicum of expense necessitated may be passed over on the theory of *de minimis non curat lex.*

An examination of the brief in *National Safe Deposit Company* v. *Stead* (*supra*), shows that it was not contended that the Illinois inheritance tax placed a financial burden on the safe deposit company nor was such situation passed upon by this court.

In the case at bar it cannot be said that the statute does not result in a deprivation of property without due process of law and a taking of private property for public use without just compensation in violation of the Fifth Amendment. The allegations of the bill above quoted show that the pecuniary burden placed upon the defendant by the requirements above quoted amounts at least to between five and ten thousand dollars a year. Such deprivation cannot be ignored as one of the trivial things concerning which the law has no care. Five thousand dollars at the least represents the entire yearly labor of one skilled accountant. A man conducting a business through the controlling interest in such a corporation as defendant is accordingly by this statute placed in a position where he has a choice of working solely for the United States Government, year in and year out, the rest of his life, without a cent of compensation, or of hiring other persons to do such work for him. He is confronted with such life labor or the necessity of hiring a substitute. As a matter of fact, the actual situation is even more extreme, for the yearly labor of no one man can perform the obligations which this statute casts upon the defendant in the case at bar. And from the standpoint of the plaintiff defendant's funds are being dissipated in a labor which brings defendant no return.

Inapplicability of decisions in respect to the police power.

In *Atlantic Coast Line* v. *Goldsboro*, 232 U. S. 548, this Court, at page 558, stated that the enforcement of uncompensated obedience to a regulation established under the police power exercised for the public health or safety was not an unconstitutional taking of property without compensation or without due process of law, but added that the *regulation must be designed to promote the health, comfort, safety or welfare of the community* and that the means employed must have a real and substantial relation to such avowed or ostensible purpose. It cannot be contended that the expenditure necessitated by collecting the tax at the source is designated to promote health or comfort or public safety.

No pretense is made that the employers, fiduciaries, debtors, trust companies or various corporations are regulated in any way for the public health, comfort or safety. It is clear that the scheme has no ulterior motive of management of business for these kinds of public benefit. The sole object of this part of the act is to obtain a collection of the tax through the unrequited labor of private parties.

Unapportioned compulsory service is not a tax.

It is equally clear that the labor necessitated by this plan of collection is in itself not a tax. Essentials of a tax are that it must be definite and generally imposed upon all of a class, with substantial equality upon all the members of each class. This burden varies with each person or corporation. It is nothing to one, a small amount to another, it is solely labor to another, it is a larger amount to a fourth. Moreover, it is a burden of labor, not a pecuniary burden, except as labor may be hired by him who is charged, whereas the characteristic element of a tax is that it is a *pecuniary* burden. The

most frequent definition is, "a pecuniary burden imposed for the support of the government" (*U. S.* v. *The Railroad*, 17 Wall. 322, at 326; *In re Farrell*, 212 Fed. 212, at 213; *Mayor* v. *Cooper*, 131 Ga. 670, at 674; *Bouvier's Law Dictionary*). It is sometimes defined as a pecuniary burden laid upon individuals or property to support the Government (*New Jersey* v. *Anderson*, 203 U. S. 483). This indefinite and varying burden, not being pecuniary in character and resulting in a financial measurement only when the person or corporation is under the necessity of hiring some one to perform it, can accordingly find no justification as an exercise of the federal taxing power.

Nor does its performance fall within any of the heads of recognized duties of a citizen such as military, jury or fire duty or service as a member of a *posse comitatus*. This obligation does not fall upon the general body of citizens but upon a restricted class, and of course nothing is necessary beyond mere statement to prove that the obligation placed upon one citizen to collect and turn over the tax imposed upon a second citizen is a duty unheard of at common law.

In *Toone* v. *The State*, 178 Ala. 70, a statute of Alabama, approved the fourth of March, 1911, declared all horses, mules, wagons, plows, etc., in the county to be subject to road duty. The court, at page 66, stated that the requirement that citizens should work upon the public road in person or by a substitute, with the authorization of a fixed sum by way of commutation, did not constitute taxation but was the execution of a public duty of the same general class as militia duty; that it seemed to be a mere personal obligation from the subject and did not entail upon him the duty of furnishing his property in connection with his personal service. The court further stated:

> "The books have been examined in vain for an authority which will authorize the exaction

> from a citizen of the contribution of his property for public service under the theory that it is his duty as a citizen to contribute."

The obligation in the case at bar falls most heavily upon corporations. The work, of course, must be performed through their agents. We do not think the novel proposition will be advanced that it is the duty of a corporation as a citizen to hire labor for the assistance of the United States Government in the collection of its taxes.

Nothing in the Sixteenth Amendment justifies or contemplates any such method of tax collecting. There is no intention displayed in said amendment that the collection of taxes on incomes shall be other than through ordinary methods of tax collection or shall in any way abrogate the constitutional guarantees of freedom of property from confiscation.

It is submitted that the Fifth Amendment providing that no person shall "be deprived of life, liberty or property without due process of law; nor shall private property be taken for public use without just compensation," is herein violated.

Provision for just compensation essential.

That enforced labor by legislative enactment without compensation is an unconstitutional taking of property was recently held by this Court in *Louisville, etc., R. R.* v. *Stockyards*, 212 U. S. 132. In that case a section of the constitution of Kentucky provided that all railroad companies should receive, deliver, transfer and transport freight from and to any point where there was a physical connection between the tracks of two companies. This Court, per HOLMES, *J.*, held that the section was unconstitutional, at page 144, saying:

> "There remains for consideration only the third provision of the judgment which requires the plaintiff in error to receive at the connect-

> ing point and to switch, transport and deliver all livestock consigned from the Central Stockyards to any one at the Bourbon Stockyards. This also is based upon the sections of the Constitution that have been quoted. If the principle is sound every road in Louisville by making a physical connection with the Louisville & Nashville can get the use of its costly terminal and make it do the switching necessary to that end upon simply paying for the service of carriage. The duty of a carrier to accept goods tendered at its station does not extend to the acceptance of cars offered to it at an arbitrary point near its terminus by a competing road for the purpose of reaching and using its terminal station. *To require such an acceptance from a railroad is to take its property in a very effective sense* and cannot be justified unless the road holds that property subject to greater liabilities than those incident to its calling alone."

A destruction of property for public purposes is as complete a taking as would be its appropriation for the same end (*U. S.* v. *Welch*, 217 U. S. 333, at 339).

When the statute has forced upon defendant an obligation, to perform which an expenditure of from five to ten thousand dollars has been necessitated, the statute in effect has taken from defendant the amount actually expended. The Government has had the benefit of labor of that value, and if there be no obligation to compensate defendant, has deprived it of that amount.

In *U. S.* vs. *Buffalo Pitts. Co.*, 234 U. S. 228, the plaintiff sold a traction engine to a government contractor retaining thereon a chattel mortgage. The contractor failed and the Government took over his property including the engine. This Court held that the Government had no right to use the property of others without compensation, at page 235, saying:

> "While the government claimed the right thus to take and use the property, it never-

> theless held it without denying the right of the owner to compensation. When it takes property under such circumstances for an authorized governmental use it impliedly promises to pay therefor. This accords with the principles declared in the previous cases in this court and arises because of the constitutional obligation embodied in the Fifth Amendment to the Constitution of the United States guaranteeing the owner of property against appropriation for a governmental use without compensation."

In *Richards* v. *Washington Terminal Co.*, 233 U. S. 546, this Court, at page 552, pointed out the distinction between the power of Parliament, omnipotent so far as authorizing the taking of private property for public use without compensation to the owner, and the power of the Federal Congress, the legislation of which must conform to the Fifth Amendment.

In *James* v. *Campbell*, 104 U. S. 356, there was involved the right of the United States to use a patented article—a stamping device—without making compensation to the holder of the patent. Mr. Justice BRADLEY, delivering the opinion of the Court, at page 358, stated:

> "The United States has no such prerogative as that which is claimed by the sovereigns of England, by which it can reserve to itself, either expressly or by implication, a superior dominion and use in that which it grants by letters patent to those who entitle themselves to such grants. The government of the United States, as well as the citizen, is subject to the Constitution; and when it grants a patent the grantee is entitled to it as a matter of right and does not receive it as was originally supposed to be the case in England as a matter of grace and favor."

In the case at bar it makes little difference whether the defendant is forced to perform labor

for the government, for its rival in business or for various groups of taxpayers. The vice of the legislation is that labor is enforced without compensation being provided. The government has no more right to take this enforced labor than it has to turn over the results of it to some private citizen.

In *Chicago, Burlington, &c., Railroad* v. *Chicago*, 166 U. S. 226, this court, at 236, said:

> "But if, as this court has adjudged, a legislative enactment assuming arbitrarily to take the property of one individual and give it to another individual, would not be due process of law as enjoined by the Fourteenth Amendment, it must be that the requirement of due process of law in that amendment is applicable to the direct appropriation by the State to public use and without compensation of the private property of the citizen. The legislature may prescribe a form of procedure to be observed in the taking of private property for public use but it is not due process of law if provision be not made for compensation."

It is no answer to this proposition to assert that due process of law is necessarily involved in any exercise of the taxing power. As above shown, this is not a tax but enforced labor in tax collection. It requires corporations and others to turn over the use of their property and to make expenditure for the benefit of the government, without compensation or reimbursement.

In *Lake Shore* v. *Smith*, 173 U. S. 684, the legislature of Michigan had established certain maximum railroad rates, but nevertheless assumed to provide an exception in favor of those able to purchase tickets at wholesale rates, at the same time lengthening the period during which such tickets should be valid. The Court, at page 691, said:

> "It thus invades the general right of a company to conduct and manage its own affairs and

> compels it to give the use of its property for less than the general rate to those who come within the provisions of the statute and to that extent it would seem that the statute takes the property of the company without due process of law."

Somewhat analogous pieces of legislation have been held unconstitutional.

In *McCully* v. *The Railroad*, 212 Mo. 1, a law provided that whenever a railroad company should receive or ship any livestock, said railroad in consideration of the usual price paid for the shipment of the car, should pass the shipper or his employee to and from the point designated in the bill of lading, without extra expense. The Court held that the act resulted in a discrimination in favor of the shipper of livestock by the railroad, as against the shipper of other classes of freight, and that the act was unconstitutional in that it deprived the carrier of its property without due process of law, in violation of the Fourteenth Amendment.

In *Attorney-General* v. *Old Colony Railroad*, 160 Mass. 62, an act required railroads to provide mileage tickets, good upon all railroads of the commonwealth. The Court, at page 89, said:

> "The most formidable objections are that the statute authorizes one railroad to determine the conditions under which another railroad must carry passengers and compels one railroad to carry passengers on the credit of another. We have been referred to no judicial decision where any such legislation has been considered.
>
> The law governing the taking of private property for public use affords some analogies which we think are applicable to the present cases. * * * The statute authorizing the taking must contain some provision for obtaining adequate indemnity. It is not enough to leave the owner to his action at law for damages. * * * *If this is true when the property taken is land, much more it is true when the property taken is*

consumed in the use so that if compensation is not ultimately paid the owner has no remedy by taking back the property. When property is taken for a public use and is consumed in the use provision for adequate compensation certainly ought to be more than a mere right of action against a private person or corporation with the risk of never obtaining satisfaction and the compensation when it is made must be made in money."

In *Chicago, Milwaukee & St. Paul Railway Co. v. Wisconsin*, 238 U. S. 491, it appeared that the State of Wisconsin had imposed a penalty on sleeping car companies if the lower berth of a sleeping car was occupied and the upper berth was let down before it was actually engaged. This statute was held to be unconstitutional under the due process clause of the Fourteenth Amendment and an arbitrary taking of property without compensation. It was also held that it could not be justified either as a health measure under the police power of the State, or as an amendment of the charter of the corporation. The Court held that notwithstanding the right of the State to regulate public charters in the interest of the public was very great, that great power did not warrant an unreasonable interference with the right of management or the taking of the carrier's property without compensation. The Court said:

> "For as the state could not authorize the occupant of the lower berth to take salable space without pay, neither can the present statute compel the company to give that occupant the free use of that space until it is actually purchased by another passenger. The owner's right to property is protected even when it is not actually in use and the company cannot be compelled to permit a third person to have the free use of such property until a buyer appears."

Of course, if Congress had determined that to meet the expense of the collection of the income

tax each corporation should contribute a varying amount of money or of its real estate and, in the case of the defendant, that either ten thousand dollars in cash or a parcel of land of the value of ten thousand dollars be given, there would be no dispute but that the law would be unconstitutional, but, it follows from the reasoning of the cases just cited, that the fact that the property here taken consists in labor or in money expended to hire labor used up in the service of the government does not in any sense justify the sacrifice demanded of defendants. The admission on the record that it is of a value between five thousand and ten thousand dollars gives it a character as definite as a parcel of real estate of the same value.

In *United States* v. *Mitchell*, 58 Fed. 993, the provision of the Act of July 6, 1892, imposing a penalty for refusal to answer questions upon officers of corporations engaged in productive industry was held ineffective because there was no provision in that or any other act requiring such corporations to answer the questions. On demurrer to the indictment it was urged that the furnishing of the answers to the questions involved a taking of property for which no compensation was made. The Court suggested that there might be a limit to the power of Congress to compel a citizen to disclose information concerning his business undertakings, and at page 999 said:

> "This limit must relate not only to the kind of information he may properly refuse to disclose, because it may be equivalent to the appropriation of private property for public use without just compensation, but also to the extent of the information required, as well as to the time within which it shall be given. Certain kinds of information valuable to the public, and useful to the legislative branches of the government as the basis for proper laws, have heretofore been voluntarily given, and may properly

> be required from the citizen, when it is not of property value, or when the collection, compilation, and preparation thereof does not impose great expense and labor for which compensation is not provided. It is not infrequent, however, that answers to questions propounded in some schedules, if fully and properly prepared, involve the collection and compilation of facts that require the labor of a large force of clerks for days and weeks, entailing great expense and embarrassment to the ordinary business of the citizen. Is it within the power of Congress to make such answers compulsory and require the citizen to neglect his usual business with loss and to prepare this information at a great personal expense without proper compensation? * * * As before stated, when such information is required as the basis for proper legislation or the just enforcement of the public laws, the power to compel its disclosure may exist and if unusual expense attends its preparation, proper remuneration to the citizen can be made."

The demurrer to the indictment was then sustained.

In the case at bar the entire absence of compensation is noteworthy. In *Merchants Bank* v. *Pennsylvania*, 167 U. S. 461, the state statute gave banks an election to collect and pay the tax on the stockholders' shares but in return for such collection the bank received certain exemptions from local taxation.

In *Consolidated Rendering Co.* v. *Vermont*, 207 U. S. 541, the Company was served with a notice to produce certain books and papers before the grand jury sitting at Burlington, in Vermont. The Company was doing business in that city. It produced certain books but failed to produce others. One of the grounds urged as an excuse was that certain books and papers had been sent on to Boston, Massachusetts, and that the collecting and sending on of the documents involved expense. The legislation, however, was sustained on the

ground that compensation in the nature of witness fees was provided by the general law of the State.

There is no such element which may be urged in defense of the present statute. No question of reasonableness of compensation arises. No compensation whatsoever is provided.

Congress in the exercise of its taxing power is nevertheless bound by the express and implied provisions of the Constitution. In *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, the Court, at 563, said:

> "On the contrary, the power to tax is so far limited that it cannot be used to impair or destroy rights that are given or secured by the supreme law of the land."

The Act not only exacts labor without compensation but exposes the defendant to unnecessary risks and perils.

One inevitable result of the provisions of the Act of October 3d in respect to collection at the source is that such a corporation as this defendant will necessarily pay to the Government a considerable amount of money as a tax upon coupons or interest on registered bonds which the Government is not entitled to, and which practically never can be recovered back from the Government. The statute requires such tax to be paid, notwithstanding that the income of the debtor of the corporation may be less than $3,000. The bill sets out that, with respect to many of its issues of bonds, this defendant corporation has agreed to pay to the Government any tax which it may be required by law to withhold from the bondholders. With respect to such bonds, therefore, as to which this contract has been made by the defendant, the taxpayer will receive his interest in full without diminution and the corporation will withhold and pay the normal tax of one per cent. upon that interest to the Government.

Many of these bondholders may be entitled to the exemption of $3,000 or $4,000 provided for by the statute, but, practically, they will never claim that exemption to the defendant corporation because the making of such a claim would involve a certain amount of trouble and be of no pecuniary benefit to the claimant, who will receive his interest in full from the defendant. The corporation is, therefore, left in the position of having paid an Income Tax on behalf of bondholders who might claim the exemption and who are not liable under the Act by reason of their incomes not reaching the amount of $3,000. The corporation has no means of ascertaining whether its bondholders are exempt or not, except by the expenditure of considerable money in compensating individuals to make investigations and collect evidence. It is no answer to say that the defendant should go to the necessary expense to find out whether its bondholders are or are not exempt and has the privilege not to pay the tax to the Governernment on behalf of such bondholders who are entitled to the exemption. The burden of defendant's complaint is that the Government throws upon it great expense in connection with the collection of taxes not of defendant but of its bondholders. The practical effect of the statute, therefore, in requiring the defendant to collect and pay the taxes of its bondholders is to inflict upon the defendant corporation in any event considerable pecuniary loss, whether that loss be in the payment of taxes to which the Government has no legal claim or in ascertaining the facts, the existence of which would justify the corporation in not paying any taxes for its bondholders.

Surely, the property of a corporation is taken for public use and without compensation when the inevitable operation of a statute is either to compel the corporation to pay taxes that are not lawfully due, or to conduct an expensive and inquisitorial

investigation into the private affairs of third persons. It is to be noticed that the statute does not exempt the corporation from withholding and paying the tax upon interest in the event that the person entitled thereto is actually exempt, but only in the event that the person entitled thereto files with the corporation debtor a claim to exemption. It is also to be noted that the statute does not protect such a corporation as this defendant, which has contracted to pay all taxes upon interest which are required by law to be withheld, by making it obligatory upon the bondholders to claim to the debtor corporation an exemption from the Income Tax Law to which he may be entitled, and it is perfectly obvious that no bondholder will go to the trouble of claiming an exemption simply for the purpose of protecting his debtor corporation from an exaction on the part of the Government of a tax on the interest when the bondholder is sure to receive his interest in full without making a claim to exemption.

The Act involves unreasonable discrimination and arbitrary classification.

The practice of collection at the source involves various discriminations between taxpayers that are unreasonable, founded simply upon the convenience of the Government, and bear no just relation to the subject matter involved. Among others may be mentioned these:

1st. A discrimination is made that involves a heavier burden of expenditure upon corporations who are indebted upon bonds or obligations for the payment of money than that placed upon those who are not so indebted.

2nd: A discrimination is created that involves a heavier burden of expenditure upon corporations

who have funded their debts in favor of corporations whose only indebtedness is of a floating character, the interest upon which is not payable at fixed periods.

3rd: A discrimination is effected that involves a heavier burden of expenditure upon individuals who are fiduciaries or employers than that placed upon those who do not occupy those relations.

There is no reasonable classification for purposes of taxation between individuals who are fiduciaries and employers and those who are not. The only basis for these classifications or discriminations is the convenience of the Government and the saving to it of expense in assessing and collecting its taxes.

An incidental effect of the system of deduction and collection at the source is the deprivation to individuals of the use and benefit of the moneys withheld to pay their taxes during the period of time between the date of the withholding and the date of the assessment of said tax or the payment of the tax.

The following extract from a paper read by Professor Charles J. Bullock, of Harvard University, at the Eighth Annual Conference of the National Tax Association is illuminating:

> "The difficulty is greatest in the case of interest on corporation bonds and other obligations since a very large proportion of these securities consist of coupon bonds, and the tax must be deducted from all payments whatever their amount. In some sections of the country the larger city banks have made arrangements by which country banks have been relieved of trouble and expense in connection with the tax, but this concentrates the burden rather than diminishes it. I am informed that one banking institution has been put to an additional expense of $15,000 per annum, and another to an

expense of $20,000. These figures are exclusive of the heavy initial cost the system entailed, and represent what is likely to be the normal outlay for these institutions. If data could be secured for the entire country the total burden would surely be impressive.

Even worse than the absolute amount of the expenditure is its relation to the amount of the tax actually paid the government. The institution that is spending $15,000 will have collected at the end of the first year $53,000 of income tax upon corporation bonds, the cost of collection amounting to nearly thirty per cent. A traction company collected $8,200 of tax between November 1, 1913, and February 1, 1914, and spent $3,299 in performing this service. Here the cost of collection rises to forty per cent. Another public service corporation collected $9,821 of tax up to August 1st, and expended $7,011 in so doing, the cost of collection amounting to over seventy per cent., but these figures may include initial outlays that will not recur. I can find no reason for thinking these cases exceptional, and they merely confirm the general opinion prevalent among those conversant with the facts, that the cost of collecting the tax on bond interest at the source is absurdly, preposterously high. The cost of collecting the customs revenue of the United States is about three and one-half per cent., and the internal revenue of 1911 cost but one and one-half per cent. The Wisconsin income tax showed a net cost of collection 1.28 per cent. in its first year. In general any tax that costs more than five or six per cent. to collect is uneconomic, and most taxes cost much less than this figure. But in respect of bond interest the government of the United States is now collecting an income tax at an expense of from thirty to forty per cent.—to other people.

My contention is, then, that collecting the income tax at source has largely changed its incidence, lowered its moral, and in some cases resulted in a preposterously high cost of collection which the government throws upon private citizens and corporations without compensation."

At the discussion which followed the reading of the above and other papers Dr. E. R. A. Seligman said (Papers and Discussion on the Federal Income Tax, Reprinted from proceedings of the Eighth Annual Conference of the National Tax Association, p. 56):

> "As I may be considered in a certain sense responsible for having foisted upon the government this principle of collection at source, I feel that a few words ought to be said on that point in order, if possible, to minimize some of the objections that have been alleged. I do not think that all of the objections can be removed. There are certain undeniable defects in the law. Whether one believes in the principle of collection at source or not, I think everyone would agree that it is unjust to put the expense of what is properly a governmental function upon individuals or the corporation. That, however, is a detail which can be remedied without abandoning the principle itself; and it ought to be remedied if the principle is retained."

Conclusion.

No attack is made herein upon the principle of collection at the source. It is conceded that it is for the Congress to determine whether that method of collecting the income tax shall be employed, provided due compensation is made to those who furnish labor and money to the Government in the assessment and collection of the tax. It is urged that it is the part of the Court to determine whether the requirements of the Government upon its citizens in the collection of the tax involve violations of the constitutional provisions, and should it be found that such violations have occurred, doubtless Congress in its wisdom will find a way to retain all the useful provisions of collection at the source, coupled, however, with due compensation to the assessors and collectors of the tax.

POINT FOURTH.

The statute is invalid in the particular of seeking to tax income received prior to October 3rd, 1913.

Section D of the Income Tax Law is as follows:

> "The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first; provided, however, that for the year ending December 31st, 1913, said tax shall be computed on the net income accruing from March first to December thirty-first, 1913" * * *

The Act became a law October 3rd, 1913. It purports, therefore, to reach back and tax amounts received as income prior to the time of its passage from March 1st, 1913.

The Sixteenth Constitutional Amendment authorized a tax on *income* without apportionment. In regard to all other direct taxes Congress is still bound by the constitutional requirement that they be apportioned.

The Pollock case (158 U. S. 601) decided that a general tax upon the income of real and personal property was a direct tax, within the meaning of that term as used in the Constitution, upon the real and personal property that produced the income, and could not be levied without apportionment. This case obliterated any distinction between income as such and the property that produced the income, regarded as subjects of taxation. It established the proposition that an income tax is one that reaches income producing property through the method of assessing or valuing it by its income producing effectiveness. The Sixteenth Amendment left every

direct tax upon real and personal property still subject to the requirement of apportionment, except such a direct tax as might be collected by the operation of a law of Congress that established a tax to be collected by the method of assessing or valuing the taxed real and personal property by its income.

It is clear that the Sixteenth Amendment was itself not legislation. It was merely permissive in character. It was a grant not an exercise of taxing power. Congress could exercise the power or decline to do so as its wisdom might decide. The Amendment was not self operative, and no tax was imposed until the power conferred was exercised by the passage of the Act of October 3, 1913. Analagous to the effect of the grant to Congress in the Constitution to pass uniform laws on the subject of bankruptcy, the power to tax incomes was dormant.

This principle was clearly stated in *Sturges* v. *Crowninshield*, 4 Wheat. 122, wherein it was held that a state had power to pass an insolvency law provided there was no act of Congress in force at the time on the subject.

MARSHALL, *Ch. J.*, at page 195 said:

> "It does not appear to be a violent construction of the Constitution, and it is certainly a convenient one, to consider the power of the States as existing over such cases as the laws of the Union may not reach, but be this as it may, the power granted to Congress may be exercised or declined as the wisdom of that body shall decide. If in the opinion of Congress uniform laws concerning bankruptcies ought not to be established, it does not follow that partial laws may not exist or that state legislation on the subject must cease. It is not the mere existence of the power but its exercise which is incompatible with the exercise of the same power by the States. It is not the right to establish these uniform laws but their actual establishment which is inconsistent with the partial acts of the States.

"It has been said that Congress has exercised this power; and by doing so has extinguished the power of the States which cannot be revived by repealing the law of Congress.

"We do not think so. If the right of the States to pass a bankrupt law is not taken away by the mere grant of that power to Congress, it cannot be extinguished; it can only be suspended by the enactment of a general bankrupt law. The repeal of that law cannot, it is true, confer the power on the States; but it removes a disability to its exercise which was created by the Act of Congress."

In *Missouri Pacific Ry. Co.* v. *Larabbee Mills*, 211 U. S. 612–623, it was held that even where Congress had already acted and had given to the Interstate Commerce Commission a large measure of control over interstate commerce, in the absence of action by the Commission, the authority of the State in merely incidental matters remains undisturbed.

See also *Minnesota Rate Cases*, 230 U. S. 352–398.

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The principle of these cases, and of the numerous decisions referred to in their reported opinions, is that the grant of power to Congress by the Constitution does not become effective until Congress exercises the power by legislation.

So until the 3rd of October, 1913, there was in existence no law of Congress on the subject of taxation of incomes or property producing income. The power of Congress to tax incomes or income producing property without apportionment prior to that day was dormant.

In permitting real and personal property to be taxed directly without apportionment, the Sixteenth Amendment limited such taxation to the single method of measuring the value of the property by its income. It follows that at the time the power

to tax comes into existence, the measure of value must then be "income," not that which has been and is not then "income."

When on the 3rd of October, 1913, the power was exercised, the question arises whether, in taxing amounts received as income since March 1st, 1913, without apportionment, the statute has kept within the limitations of the constitutional amendment that gave only power to tax *income*.

That power was one to tax the real and personal property that produced the income, and could only be exerted to cover a period subsequent and not prior to its exercise.

Prior to October 3d, 1913, real and personal property producing income were as free from any liability to the payment of a tax based on income as if the Sixteenth Amendment had not been passed. The second section of the Tariff Act in taxing real and personal property directly and without apportionment for the period from March 1, 1913, to October 3d, 1913, assessed or valued by its income is ineffective because that method of taxation had not been created by Congress until October 3d, 1913. Prior to that date it was not in existence and was prohibited by the provisions of the Constitution above set forth.

This is a matter of the construction of the Sixteenth Amendment and the meaning to be given to the word "income." The measure of the value of the property to be taxed must be "income" during the period within which this method of taxation exists. Prior to October 3d, 1913, that which was income subsequent to March 1, 1913, had ceased to be income, and therefore could not be taken as a measure of value of real and personal property to be taxed directly without apportionment.

The problem is as to the status of amounts already received as income prior to the time of the passage of the act. No question of doubt as to the intention

on the part of Congress is presented. It intended to tax directly the property that had produced the income received by the taxpayer between March 1st, 1913, and October 3rd, 1913, without apportionment. No legislative *fiat* of October 3rd, 1913, however, could change what already existed. Such amounts as had been received by the taxpayer prior to that date were no longer income but had become capital and merged in the general *corpus* of his estate.

The distinction between income and capital is plain.

In *Merchants' Ins. Co.* v. *McCartney*, 1 Lowell, 447, plaintiffs, as stockholders in the Suffolk Bank, received an extra dividend declared by the bank on the 3rd of January, 1865. The defendant, as tax collector, acting under the income tax law of June 30th, 1864, collected from plaintiff a tax on the whole amount received by them. But of the dividend declared by the bank, about three-tenths consisted of profits laid aside before the passage of the first internal revenue law. On the remaining seven-tenths the plaintiffs paid the tax.

LOWELL, *D. J.*, said:

> "As to the three-tenths it seems to me to have been a division of capital, a return to the plaintiffs in money of a part of the property which was already in their ownership as capital stock when the first tax was passed. If the Suffolk Bank had been wholly wound up, and had returned to its stockholders the exact value of their shares in money, having made no profits since the passage of the original act, this sum could not be taxed as income, gains, or profits; and so of a part. If the plaintiffs on receiving the money chose to divide it among their own stockholders, still it is not a dividend out of gains and profits, nor out of the surplus funds, because the surplus funds that are taxable, are those which are or have been made out of profits, since the passage of the act. This view ap-

> pears to have been acquiesced in by the Government, for they have neglected for some five years to enforce the opposite construction against the bank; and if this money was capital in the hands of the bank it was still capital when it reached the stockholders. The tax is assessed on the bank for convenience, but is intended to be, in effect, a tax on the shareholders; and if the latter be not assessable for the income tax it cannot be levied on the corporation."

Further on, in his opinion, the learned Judge stated that in drawing the above conclusion he had not referred to a certain section of the revenue act, "because it seemed to me the result was the same *upon any fair meaning of the word income.*"

In *People ex rel. Cornell* v. *Davenport*, 30 Hun, 177, the Court, at page 177, defining income, said:

> "The income from an investment is that which it earns, remaining itself intact."

Income is that which comes or is coming in, not that which has come in. It exists only during a period of transition. The Century Dictionary defines it as

> "A coming in; arrival, entrance; introduction. * * * That which comes in to a person as payment for labor or services rendered in some office or as gains from lands, business, and investment of capital, etc. * * *"

In *Sun Mutual Ins. Co.* v. *The Mayor*, 8 N.Y. 241, the plaintiff had accumulated certain profits. Action was brought, among other things, to restrain the collection of taxes thereon. The Court held that the accrued income constituted capital and was subject to the tax.

Prior to October 3rd, 1913, income was not lawfully a measure of value of real and personal property to be taxed directly by Congress without apportionment. The taxing power had not been

exercised with respect to that matter. Income rereceived prior to October 3rd was free from taxation or more properly, free from service as a measure of value of property, when received. All amounts received by the taxpayer prior to October 3rd, 1913, came into his hands free from any burden of taxation that had been imposed by Congress upon it or upon the property that had produced it. That burden could not be imposed by legislation enacted subsequently to its receipt. Clearly the property, real and personal, that produced that income was not subject to taxation without apportionment prior to October 3rd, 1913, or for any period prior to that date.

Income may be received either in cash or in property. It can only be income once and that is at the moment of its receipt. Before that moment it is mere expectation; afterwards it is an increment to capital. Therefore, a power to tax income can be exercised only by taxing it at the moment when it comes in. If not then subject to taxation the opportunity of taxing it cannot be revived by any legislative action because the legislature cannot take a portion of a man's capital and reconvert it into income by a statute. Immediately upon its receipt income loses its distinctive character as such and becomes part of the *corpus* and capital of an estate. Whether, therefore, the attempt to tax income received prior to October 3rd, 1913, be regarded as a tax on the real or personal property that has produced the income or on the kind of property in which the income is paid, there is an attempt to collect a direct tax upon real and personal property without apportionment for a period for which no valid tax has been imposed by Congress.

The Sixteenth Amendment did not confer the power to tax persons with respect to incomes earned or received in the past, or to tax property by reason

of the fact that at some time previous to the exercise of the taxing power, it had produced income. The Amendment only purports to confer the power to tax property in the act of producing income valued by that income. In other words, the Amendment conferred no power of retroactive legislation, but only the power that Congress might enact a statute to reach property valued by receipts at the time such receipts were income.

That gains in years past are not properly the income of the present was held in *Gray* v. *Darlington*, 15 Wall. 63, wherein plaintiff in 1865 had obtained certain United States bonds. In 1869 he sold them at an advance of $20,000. The collector levied a tax upon this amount, claiming that it constituted "gains, profits and income" for the year 1869.

The Court, however, held that it was an increase of capital, at page 66 saying:

> "The rule adopted by the officers of the revenue in the present case would justify them in treating as *gains of one year* the increase in the value of property extending *through any number of years*, through even the entire century."

In construing the provisions of a constitution or constitutional amendment it should be borne in mind that such instruments are really the work of the people. Although subject to ratification by State Legislatures, the adoption or rejection of an amendment to the Constitution of the United States depends largely upon the response given by the public mind to the words of the amendment as proposed by Congress. Therefore it is reasonable to take the words of such an instrument in their ordinary or popular sense and to interpret them in the light of those analogies which come closest to the affairs of daily life in connection with which such words are oftenest used.

It may safely be said that in the experience of the

ordinary man the words "income" and "capital" are oftenest thought of in connection with trust funds and decedents' estates.

October 3rd corresponds to the date when a bequest of income takes effect. All income received or acquired by the testator or the estate before that time is capital.

The method of apportioning stock dividends between life tenant and remainderman, under the so-called Pennsylvania or American rule, furnishes an analogy. Earnings before the life estate arose are capital and go to the remainderman. So much of the dividend as was earned thereafter is considered earnings or income and goes to the life tenant.

So in *Biddle's Appeal*, 99 Pa. St. 278, the Court at page 282 said:

> "The entire value of the stock, with all its incidents, at the death of the testatrix, constituted the principal of the estate. On this principal the appellant was entitled to the income. * * * Whatever was capital must remain capital. The executor could not take therefrom and give to the life tenant, to the injury of the residuary legatee."

And referring to an earlier case:

> "That which had accumulated before the death of the testator, was held to be a part of the principal of the fund, and that which accumulated after his death, to be income."

See also

Goodwin v. *McGaughey*, 108 Minn. 248, at p. 254.

Kalbach v. *Clark*, 133 Iowa, 215, at p. 218.

On the 3rd of October, 1913, it is apparent that the income which had then accrued had taken a multitude of forms and had suffered many changes. It had been used up. It had been lost. It had been placed in banks. It had been invested. It had be-

come a part of this corporation's surplus, of that corporation's plant, of this man's working capital and of that man's real estate.

It is not necessary for us to maintain that in all instances and under all circumstances the income which had accrued during the period concerned had at the time it was taxed not been spent or dissipated but had accumulated and become capital. Beyond dispute, a part, a great part of it, had then become capital. It is enough that it was not income on October 3rd, 1913, and therefore not available as a measure of value of taxable property.

The power to legislate under the Sixteenth Amendment might have remained dormant for ten years. At the expiration of that time, suppose Congress had passed an act taxing all moneys received during the ten years that had elapsed subsequent to the adoption of the Amendment. During that period many fortunes might have been built up entirely out of savings from income, and yet the entire capital of the taxpayer would have been subjected to the tax as income. Further there would be compounding of the tax, for that which was income the first year and taxed as such would be capital producing income the second year, and again taxed through the assessment of its income, and this process would be continued during the ten years. Once admit that Congress has power to legislate with the effect of taxing income received prior to the date of enactment, the conclusion cannot be escaped that there is no limit to the extent of time to be covered by such retroactive legislation. This conclusion follows if the statute be held validly to tax the income from March 1, 1913, to October 3d, 1913.

As the statute which taxes income received prior to October 3rd, 1913, levies a tax upon property, real and personal, directly and without apportionment, it is unconstitutional and invalid.

The decision mainly relied upon to sustain the retroactive feature of the Act of 1913 is *Stockdale* v. *The Insurance Companies*, 20 Wall. 323. That decision, of course, can have no bearing upon the construction of the Sixteenth Amendment, which did not then exist. All that was really decided in that case was that if Congress had power to impose a tax on dividends arising from the earnings of corporations, as an excise tax, (and the power to impose such an excise tax without apportionment based upon any enumeration was a question not raised in the case) then Congress had power to measure the excise tax by earnings already realized, as well as by earnings to accrue in the future. There was no constitutional provision or principle called to the attention of the Court which required the Court to distinguish between a tax on income and an excise tax measured by past income.

The passage in the opinion of the Court upon which the greatest reliance is placed by the Government is the following (p. 331):

> "The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, cannot be doubted; much less can it be doubted that it could impose such a tax upon the income of the current year, though part of that year had elapsed when the statute was passed. The joint resolution of July 4th, 1864, imposed a tax of five per cent. upon all income of the previous year, although one tax on it had already been paid, and no one doubted the validity of the tax or attempted to resist it."

It is clear that the Court attached more weight to the general acquiescence in "War taxes" on patriotic grounds than would now be considered proper. The excesses of authority on the part of Congress which are acquiesced in in a time of civil war ought not to be made permanently a part of

the constitution of a re-united nation, without some examination in the light of constitutional provisions. It should be remembered, also, that the statute which the Court was construing was not one which imposed a new tax *ab initio*, but was merely one declaring the construction of a prior statute, and it was sustained as valid upon that ground. It is true that the language of the prevailing opinion speaks of imposing a tax upon a year's income, although part of that income had already been spent or had become merged in capital. There was, however, no circumstance in the case which required the Court to consider whether such use of language was strictly accurate or not. It should be borne in mind that there was no suggestion in the *Stockdale* case that the tax in dispute was a direct tax, or that any apportionment among the several states was essential to its validity. That being so, it made no difference whether the tax was technically a tax on income or on something else. The decision is certainly not one which can have any controlling weight in determining the meaning of the word "income" as used in the Sixteenth Amendment.

POINT FIFTH.

The entire assessment of income tax against the defendant for the year 1913 is invalidated by the inclusion therein of the amount improperly assessed relative to the income received between March 1st, 1913, and October 3rd, 1913.

From the considerations presented under the foregoing Fourth Point it necessarily follows that the

Commissioner of Internal Revenue was without jurisdiction to make an assessment of any amount upon the income of the defendants for the year 1913, except upon evidence showing that income had accrued to or been received by the defendant subsequent to October 3rd, 1913. It will not, we think, be disputed by the Government that during the pendency of this suit that the Commissioner did make an assessment upon the income of the defendant for the whole period of ten months, from March 1, 1913, to December 31, 1913, inclusive, without distinguishing in the assessment between the period preceding and that following October 3rd, 1913, and without any evidence as to the receipt of income by the defendant after October 3rd, 1913. This, we submit, makes the entire assessment for the year 1913 void and entitles the plaintiff to an injunction restraining the defendant from paying any part of the tax assessed for said year.

It has repeatedly been held that where an assessment rests in part upon a subject over which the assessing authority has no jurisdiction or where the tax is levied in part for an illegal purpose and no method appears whereby the legal element can be separated from that which is illegal, the whole tax, or the whole assessment, as the case may be, is void.

Stetson vs. *Kempton*, 13 Mass. 272, was the case of a tax levied in part for an illegal purpose, It was held that the act of the collector in seizing the property of the plaintiff's intestate for the payment of the tax was a trespass and could not be partially justified by showing that some of the purposes for which the tax was levied were legal. The Court said:

> "It is further objected, that, as part of the money composing this tax was raised for legal purposes, the assessment must be considered so far legal as to support the warrant issued by the defendants; otherwise, they may be held to pay

in damages for money which lawfully belonged to the Town. But when a part of the tax is illegal, all the proceedings to collect it must be void; as it is impossible to separate and distinguished, so that the act should be in part a trespass and in part innocent."

Libby vs. *Burnham*, 15 Mass. 144, was likewise the case of a tax raised in part for illegal purposes. The action was trespass against officers who made a seizure of plaintiff's oxen for the collection of the tax. The Court said (p. 148):

"A tax is no debt, until it is assessed and demanded; and if not legally assessed, it is the same as if never assessed at all; so that to reduce the damages, on the ground that the plaintiff owed a part of the money claimed from him, would be unauthorized by legal principles.

What then, is to be done, when assessors have neglected their duty or gone beyond their authority? Is the whole tax to be lost? There is no need of this. The tax may be reassessed, or the town may renew their vote to raise the money. And it is better that they should suffer this inconvenience than that the property of the citizen should be taken from him, to satisfy arbitrary exactions, limited by no rule but the will of assessors. Strictness in these particulars is wholesome discipline—as it will, from motives of interest, produce care and caution in the selection of town officers, and diligence in them when chosen."

To the same effect is the decision in *Joyner* v. *Third School District*, 3 Cush. 567 and *Freeland* v. *Hastings*, 10 Allen, 570.

Johnson v. *Colburn*, 36 Vt. 693, was likewise the case of a tax levied in part for illegal purposes. The plaintiff sued in replevin for a cow taken under a warrant for the collection of the tax. The Court said (p. 695):

"If any part of the tax is void, it being entire, the whole is void."

In *Lacey* v. *Davis*, 4 Mich. 140, it was held that where the supervisor in levying a tax without any action of the electors or the township board added a certain amount to the tax roll for township expenses, the whole tax was void and a title acquired by sale thereunder was ineffective.

In *Clarke* v. *Strickland*, 2 Curt. 439 (Fed. Cas. 2864), it appeared that county commissioners in levying a tax had assessed a larger sum than was granted by the Legislature. The District Judge, following *Stetson* v. *Kempton*, *supra*, and *Libby* v. *Burnham*, *supra*, said:

> "The additional tax imposed by them was an an excess of power that rendered the whole tax void so that the State tax was all that was legally due."

A like conclusion was reached in the case of an excessive tax in *Worthen* vs. *Badgett*, 32 Ark. 496.

In *Union National Bank* v. *Chicago*, 3 Biss. 82, Judge BLODGETT granted injunctions against the collection of taxes based upon an assessment of the property of the plaintiff, including certain shares of national banks. Having reached the conclusion that such taxation was void as to all shareholders not residing in the district where the bank was located, he held that it must be void in its entirety.

In *Santa Clara County* v. *Southern Pacific R. R.*, 118 U. S. 394, this Court adopted and followed the rule laid down in *Libby* v. *Burnham*, *supra*, and *Johnson* v. *Colburn*, *supra*, in respect to the validity of the tax embracing some illegal elements. In that case it appeared that the assessment considered by the Court was made by the State Board of Equalization, which was required by law to assess the franchise and roadway of railroad companies. In making this assessment they had included the value of fences which the railroad company was required by law to maintain between its own land and that of

adjoining proprietors. The Court reached the conclusion that these fences were not a part of the roadway and that the assessment thereof was not within the jurisdiction of the State Board of Equalization. Consequently, the Court held that the entire assessment was void. Mr. Justice HARLAN, delivering the opinion of this Court, said (p. 416):

> "The case as presented to the court below was therefore one in which the plaintiff sought judgment for the entire tax arising upon an assessment of different kinds of property as a unit—such assessment including property not legally assessable by the State Board and the part of the tax assessed against the latter property not being separable from the other part. Upon such an issue the law, we think, is for the defendant; an assessment of that kind is invalid and will not support an action for the recovery of the entire tax so levied."

In *Alexandria Canal Co.* vs. *District of Columbia*, 5 Mackey, 376, the Supreme Court of the District, following the decision of this Court in *Santa Clara County* vs. *Southern Pacific R. R.*, *supra*, held that where a tax was levied in part upon the real and personal property of the plaintiff and in part upon its franchise the inclusion of the latter element was without jurisdiction and the whole tax was void.

In *Alexandria Canal Co.*, 1 Mackey, 217, it appeared that the assessor had included in his assessment the value of an entire bridge, part of which was within the jurisdiction of the State of Virginia. The Court held the entire assessment to be void.

Conclusion.

The plaintiff is entitled, therefore, to an injunction against the payment of any part of the tax assessed upon the defendant for the year 1913.

POINT SIXTH.

The decree dismissing the bill of complaint herein should be reversed and the appellant should be adjudged to be entitled to a decree enjoining the defendant, the Union Pacific Railroad Company:

First: From including in its returns of income and paying a tax upon amounts received by the defendant as dividends upon stock held by it in other corporations.

Second: From making any returns and any payments relating to the normal tax upon those entitled to the payment of coupons and registered interest upon its bonds, and, generally, from compliance with the provisions of the Income Tax Law with respect to collection of income tax at the source.

Third: From paying any tax upon its income for the year 1913.

September 18, 1915.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Morton O. Ellsworth

Of Counsel for Appellant.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1915.

No. 140

FRANK R. BRUSHABER,

Appellant,

vs.

UNION PACIFIC RAILROAD COMPANY.

No. 693.

TREE REALTY COMPANY,

Plaintiff-in-Error,

vs.

CHARLES W. ANDERSON, Collector of Internal Revenue.

No. 694.

EDWIN THORNE,

Plaintiff-in-Error,

vs.

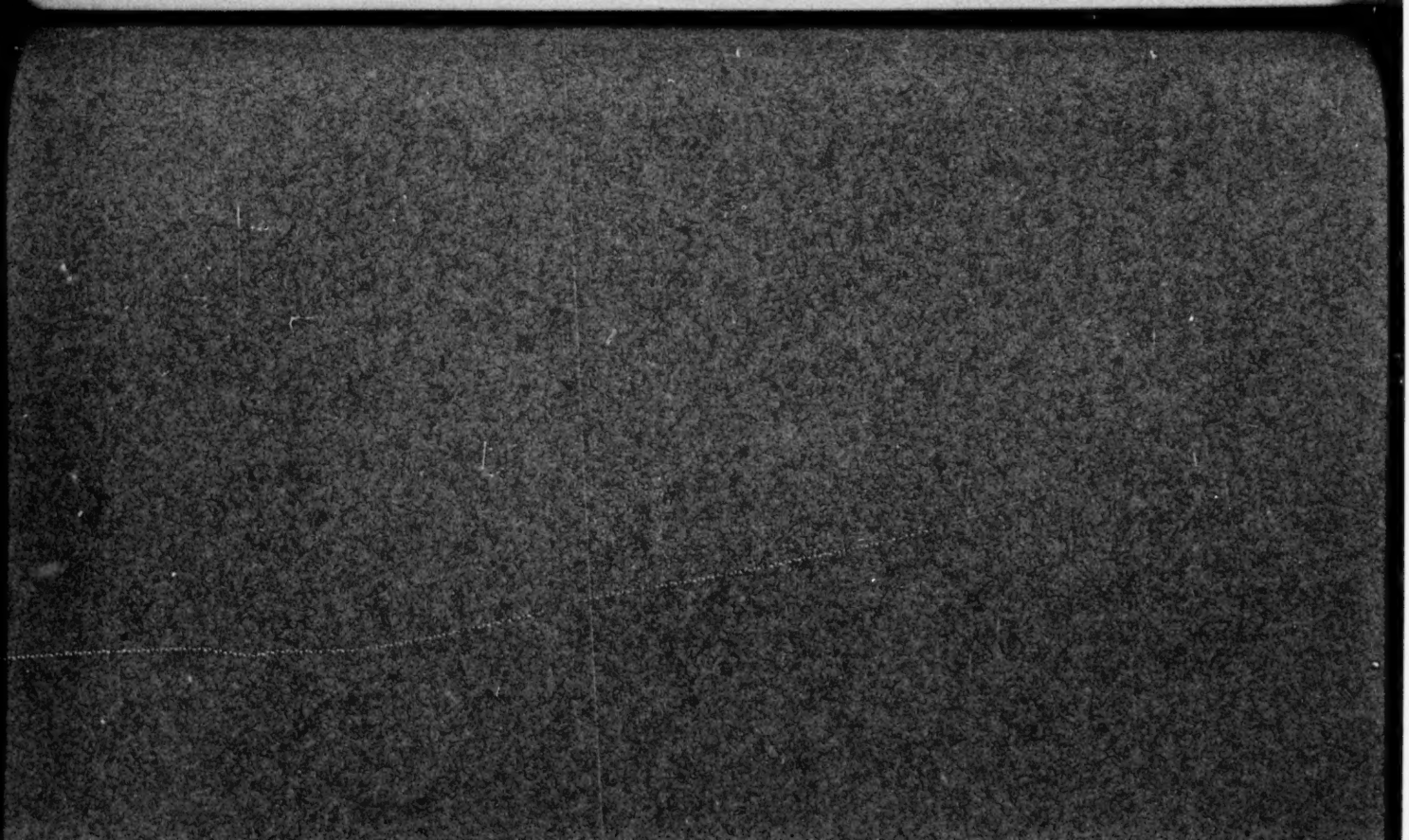
CHARLES W. ANDERSON, Collector of Internal Revenue.

ARGUMENT

OF

JULIEN T. DAVIES.

Law Union Print & Publishing House, Inc., 120 Pearl St., N. Y.



OPENING ARGUMENT.

Mr. Davies: May it please the Court, in these cases that are argued together, there are different questions presented, and while there are some questions that are common perhaps to all of the cases, I shall present those that are peculiar to the three cases that have been first named by your Honor, the Brushaber case, the Tyee case and the Thorne case.

The Brushaber case is a suit brought by a stockholder of the Union Pacific Railroad Company against that company to restrain it from voluntarily paying certain taxes assessed or claimed under the income tax law, section 2 of the Tariff Act of 1915. The other cases, the Tyee Realty Company case and the Edwin Thorne case, are suits brought against the Collector of Internal Revenue to recover back income taxes after they had been paid under protest and duress, and after an appeal had been denied by the Commissioner of Internel Revenue.

All of these cases were disposed of below on demurrer, and judgment was granted against the complainant in the first case, and the plaintiffs in the two other cases, and they come here appropriately by writ of error in the two law cases and by appeal in the equity case.

The questions in the Brushaber case that are presented are these:

First, that the Union Pacific Railroad Company should be restrained and enjoined from voluntarily paying under the provisions of the Tariff Act, the normal tax of one per cent. upon the dividends received by it upon stock that it held by way of ownership in other corporations.

The second question is that the Union Pacific Company should be restrained from acting as collector at the source voluntarily paying to the Government not its own taxes, but taxes assessed against or claimed against bondholders and recipients of interest, either by way of coupons or registered interest.

The third question in the Brushaber case is that the company should be restrained from voluntarily paying a tax upon its own income for a period from the first of March, 1913, the day when the Constitutional Amendment, the 16th Amendment, was adopted, until October 3, 1913, the date when the Tariff Act was enacted and Congress used the power which had been conferred upon it by the 16th Amendment.

In the Tyee Realty Company case there are two questions that are presented to the Court.

One is the question of discrimination against the corporation, growing out of its indebtedness.

The Tyee Realty Company is a corporation that has a capital stock of $10,000, and a mortgage debt of $270,000. The rule enacted by the income tax law was that a corporation, in ascertaining its net income, should not be allowed to deduct all the interest paid upon its bonded indebtedness, but might deduct only the interest upon an amount of bonded indebtedness which was equal to the sum of one-half of its indebtedness, plus the par of its capital stock.

Your Honors will see, of course, that in the case of a corporation like this, whose capital stock is less than its bonded indebtedness, the corporation does not deduct, in estimating its income, all of the interest that it pays. Here we have $270,000 of mortgage bonds and $10,000 of capital stock. One-half of the mortgage indebtedness would be $135,000, to which can only be added the capital stock, $10,000. We, therefore, can deduct the interest only upon $145,000

in place of the right to deduct the interest on $270,000; whereas a corporation similarly situated that has a bonded indebtedness of $270,000 and a capital stock of $135,000, can deduct interest on indebtedness equal to one-half of the indebtedness, $135,000, plus the amount of the capital stock, $135,000, making $270,000, the whole amount of the mortgage indebtedness.

That concrete example shows to the Court the discrimination against corporations which happen to have a capital stock less than one-half of their indebtedness.

In the Tyee case, also, the question is presented of paying the tax upon income received before the act was passed by Congress.

In the case of Edwin Thorne we present only the questions of the validity of the sur-tax, upon incomes over $20,000, and the validity of the tax on income received before October 3, 1913.

While the bill of complaint in the Brushaber case sets forth a great many other imperfections and objections to the act, these are the only ones that we here argue, and I would call the attention of the Court to the fact that every one of these questions does not involve the sweeping and tremendous consequence that would arise from declaring the Income Tax Law as a whole invalid. No such attack upon the law is made here—at least by me—and I simply present to the Court these particular questions, the decision of every one of which, in accordance with our views, would not disturb the tax law as a whole, though it would probably seriously interfere with its operation, and would pare off from it, as we think, excrescences and invalid provisions.

My time is so short that I am not going through the allegations of the complaint. They are all set forth in the brief. The Court will assume, I hope, that in the absence of any objection, and no objec-

tion is made by the Government, that my allegations in the bill in the Brushaber case and in the other cases are sufficient to raise the questions which I bring before the Court. But the Government does raise a jurisdictional question with respect to the Brushaber case, but not with regard to the two actions at law.

The contention is—and this is the only objection that is made to the suit—that it seeks to do indirectly what the Revised Statutes have said shall not be done; namely, enjoin the collection of a tax. The answer to that objection by the Government is that the bill does not seek to do any such thing. It does not seek to enjoin the collection of a tax. It does seek to enjoin the voluntary payment of a tax; in other words, the bill demands that the Union Pacific Road in its dealings with the income tax, should protect the interests of the company and of the stockholders by not voluntarily paying certain taxes, with the effect, that if the taxes be paid, the company should pay them under such circumstances, that if it eventually turns out that the taxes are invalid, the company is in position to recover them.

Therefore, the argument that the bill violates that provision of the Revised Statutes, even supposing that it applies to such a suit as this, where the action is properly brought by the stockholder against the corporation, cannot be upheld.

As a second proposition, with respect to the scope of the bill, we would call attention to the fact that by reason of the fact that the expense to the defendant of acting as assessor and collecting bondholders' taxes for the Government is between five and ten thousand dollars annually, we are asking that the Union Pacific be restrained from voluntarily paying the taxes of third persons, and, in no event, I take it, would this provision of the Revised Statutes apply to an action brought by a stockholder against his corporation to restrain that

corporation from paying not its own tax, but the tax of a third person, and in our attack upon what is called collection at the source, contained in the income tax law, we are only asking that the taxes of third persons be not paid by the Union Pacific.

The Sixteenth Amendment.

The first matter that I want to bring to the attention of the Court is a general view of the 16th Amendment. The language of the 16th Amendment to the Constitution is as follows:

"Congress shall have power to lay and collect taxes on incomes from whatever source derived without apportionment among the several states, and without regard to any census or enumeration."

The first thought is that it is a grant of power to Congress to lay taxes upon incomes from whatever source derived, as a class; that a specific piece of property, a specific kind and class of property, to wit, incomes, is taken out and is relieved from the restraint of the Constitution, that direct taxes upon property can only be laid by apportionment with respect to numbers.

The class of property that is subject to the tax is incomes, generally, and therefore, it was a general income tax, an income tax upon the income of all the property of the tax payer, from all sources, that was permitted to be levied, without apportionment.

Of course, I need dwell but for a moment upon the history of the amendment. We all know, because this Court has so decided, that the general Income Tax of 1894 was invalid, for the reason that a general income tax upon all the income from a man's real and personal property was a direct tax upon that property. After the Court had held that that tax was a direct tax and therefore, under the provi-

sions of the Constitution, could not be levied without apportionment among the several states, according to population, this amendment was passed to meet the difficulty raised in that case, and the language of the amendment indicates that it was one class of taxes that were allowed to be laid upon one class of property, and that the only case in which direct taxes were permitted to be levied by Congress without apportionment according to population was that of a general income tax upon all the income, taken as whole, upon the bulk of a man's property, real and personal.

And further, when the word "income" was used, it was meant income that was net. It was not gross income, that could be taxed in the case of some corporations or individuals, but it was in every case the income from whatever source derived, the income as a whole of the taxpayer, and that necessarily must be net income, because the ordinary meaning of the word "income" is not gross income or gross receipts, but net income, after making the deductions which diminish a man's income and diminish the ultimate profit to him as a result of his entire activities. Suppose the income tax—as an illustration of what I am trying to express—suppose the income tax law had provided this: That the incomes from all the gold mines in the United States should pay at a certain rate, and the incomes from all of the silver mines in the United States should pay at another rate. There we would have a classification of incomes and also a classification of the properties producing the incomes. We would not have in either of those taxes, I venture to say, a tax which Congress was authorized to lay by the 16th Amendment, because we would not have a tax that was in reality a tax on income. The essence of a tax, and the essence of the incidence of taxation, is that it falls upon that which is the differentiating characteristic of the subject of the tax. An income tax, gen-

erally speaking, is a tax upon the income as a whole of the taxpayer; a tax upon the income of the taxpayer derived from gold mines is no longer an income tax. It is a tax upon gold mines. The specification as the subject of the tax of income of a gold mine furnishes a differentiating characteristic from other taxes on incomes.

That illustrates the thought that I am trying to bring before the Court, that a proper construction of the 16th Amendment is this: That it involves the general features of a general tax upon the income of the taxpayer, taken as a whole, and therefore, that varying rates under the income tax, selection of certain subjects and certain kinds of income from specific pieces of property for increased taxation, are not within the power granted, but the moment you get into these specific instances of varying taxes, you have gone beyond the freedom from the restraint of the provision of the Constitution that direct taxes must be laid by apportionment.

If I am right about this, the consequences are that, substantially speaking, no classification with the result of different rates upon incomes can be had under the income tax law. I am not going to argue the proposition which was disposed of in the Pollock case, that certain exemptions—although the question is in the bill—that certain exemptions which have found their way into the act with regard to charitable institutions and life insurance companies should not be allowed —I pass all that.

Bnt we have here in this Act grave discriminations. We have provisions which tax certain corporations at a greater rate than other corporations, who are absolutely their direct competitors and belong in every proper sense and point of view to the same class, and these discriminations exist

not only between different classes of taxpayers, but between members of the same class of taxpayers.

In the Pollock case, on the first argument the Court was equally divided on the question of uniformity, and some very strong opinions were written on that subject. When the case was argued a second time, that question dropped out of the case, because the Court came to the conclusion that the tax on the general income of the taxpayer was a direct tax upon his property, and it was not necessary to decide that question.

If the Court comes to the conclusion that there is this power of classification, which includes the power of imposing different taxes by way of differing rates on different classes of property or upon the same class of property held under differing circumstances, we have the entire protection of the provision of the Constitution that direct taxes should be apportioned according to the populations of the States swept away by this 16th Amendment. There is no half-way house about it.

Congress then would have all the power of the States to impose direct taxation and, therefore, to regulate all the activities of the citizens.

In thus urging that the Sixteenth Amendment shall be confined to its obvious and evident purpose —that of authorizing a general income tax upon all incomes derived from all sources—we are not, as we conceive, advancing an argument that weakens, but rather one that really strengthens, the fiscal powers of Congress. If Congress has power to select out particular sources of income for exclusive taxation —if Congress has power to discriminate and to unequally tax different sources of income—if Congress has power in what purports to be a general income tax law to create discriminations, exemptions and inequalities—the entire field that is now occupied by state taxation and a broader field than that occupied by states whose constitutions contain

a clause requiring equality and uniformity in the levying of taxes would be thrown open for the action of Congress. The halls of Congress will necessarily become a battleground not only for conflict between the interests of different classes of our people of varying degrees of wealth and accumulated property, but between the different classes of owners of different kinds of property, whether individuals or corporations, and of different classes of industrial activity. Struggles will necessarily ensue for the favor of Congress in lightening the load of taxation upon this or that interest, and all the unseemly struggles that have scandalized the country in the enactment of tariff bills will be repeated and extended to the enactment of income tax laws. Such, as it seems to us, would be the consequences of an interpretation of the Sixteenth Amendment that extended the powers of Congress beyond those of enacting a general income tax law upon all incomes from all sources without apportionment.

The questions that I have stated raise the objections of discrimination and classification and of taxation of certain corporations at larger rates than other similarly situated corporations.

Dividends on Stocks.

There is a discrimination with respect to the receipt of dividends derived from stocks that a corporation may hold in other corporations. For instance, the provision of the law is that an individual, in paying his normal tax, can deduct from the amount assessed against him the amount of dividends that he has received upon the stocks of corporations.

The reason of this is that the corporations pay the normal tax of one per cent. on their net incomes.

When you come to a corporation owning stock

in other corporations, you encounter an unreasonable discrimination.

The reason why the corporations should have the deduction is, because the dividends that they receive from stocks that they own in other corporations, have already paid the normal tax, but although that reason exists, the fact does not exist. The corporation is not allowed to deduct from its net income for the purpose of its normal tax the dividends received upon its owned stocks.

It is true that this is not one of these discriminations that are based upon the character of the property. It is based upon the circumstance that a corporation and not an individual owns stocks.

The real grounds of the discrimination are that the corporation, organized by a state, has exercised the power granted to it by the state to hold stocks in other corporations, and that circumstance, which has no relation whatever to the matter of taxation, which does not change the attitude of corporations with respect to their business, has nothing whatever to do with their earning capacity, is a discrimination against companies owning stocks, even if they are not holding companies. This is a discrimination, not against a specific kind of property, but against a specific form of holding property.

It is perfectly obvious that the effect of this discrimination against companies owning stock in other corporations, is to tax them at a greater rate than that imposed upon the corporations which do not hold stock in other corporations, and it is obvious too that it involves taxing at a greater rate the individuals who own stocks in corporations that own stock in another corporation, than individuals that own stock in corporations that own no stock in other corporations. This is discrimination between members of the same class, not merely between different classes.

The effect upon this defendant of this provision of

law is very disastrous. The Railroad Company is the owner of the entire capital stock, amounting to $100,000,000 of the Oregon Short Line Railroad Company, which in its turn is the owner of the entire capital stock (less 15 shares) of $50,000,000 of the Oregon-Washington Railroad & Navigation Company. Both the last named corporation and the Oregon Short Line are consolidations of the original corporations by which branches and extensions of the Union Pacific were constructed. The Union Pacific also owns stock in a fruit express company, an equipment association and various other corporations engaged in business other than railroad business, but incidental thereto. The effect of this discrimination against corporations holding stock in other corporations is to compel the Union Pacific Company to pay three taxes upon income derived through the Oregon-Washington Railroad & Navigation Company and two taxes in the case of income derived through the other controlled corporations, and these thricefold and twofold taxes ultimately fall upon the individuals who own the stock of the Union Pacific Railroad Company, while individuals whose earnings are not derived in any respect from stock of corporations are not subjected to more than one normal tax upon their incomes.

The allowance to individuals, in computing the income for the normal tax, of a deduction of dividends received from corporations is a recognition by Congress of the principle that a corporation is, in substance, an aggregation of its individual stockholders and that whatever affects injuriously the net income of a corporation must finally and ultimately fall upon the individual stockholders. The effect, then, of this denial to corporations of the right to deduct, in ascertaining their net income, dividends of other corporations is to impose a penalty upon individual stockholders of corporations for owning stock in corporations which themselves

own stock in other corporations, and to regulate and discourage the exercise of the right, conferred by the different states who have authorized the organization of these corporations, of a corporation to hold stock in another and of an individual to hold stock in such a corporation. The incidence of the tax in these cases is upon not the income of the corporations but upon the corporation as such and by reason of its holding stock. Is not this a direct tax without apportionment upon the property of such a corporation, not as part of a general income tax upon incomes from whatever source derived, but, in addition to such an income tax, a further burden imposed by reason of the fact of holding stock, and therefore a direct tax upon property without apportionment so far as the excess is concerned? There is no difficulty in dealing with this matter practically without disturbing the operation of the Income Tax Law as a whole. Every corporation knows what part of its net income is derived from the stock of other corporations, and, if entitled to a deduction, the deduction can be allowed either before the tax is assessed and paid or by recovery afterwards without any practical difficulty.

That Congress intended this provision of law as a discouragement to corporations holding stock, whether they were holding companies strictly speaking, or only partially such, and that Congress, considering that it had the power to tax in this manner, intended to exercise its power to destroy, is shown not merely by this provision itself but by other provisions of the Income Tax Law. The Act provides for two cases of presumed fraudulent purpose to escape the tax: one is where the gains and profits are permitted to accumulate beyond the reasonable needs of the business and the Secretary of the Treasury has certified that such accumulation is unreasonable; the other is where the corporation is a mere holding com-

pany. A corporation being a mere holding company is, for that reason alone, presumed to be fraudulent in purpose. This discrimination cannot be upheld without a claim that Congress has the power through taxation of incomes to regulate the mode of ownership of property within the several states by their corporations and their individual citizens. It is well known that the rules in different states are very different in regard to the ownership of stock in corporations by other corporations, and especially railroad corporations such as the defendant. Sometimes the right of such ownership is unrestricted; sometimes the ownership of stock in parallel or competing lines is prohibited.

Reasonable Classification.

Apart from the position that this provision of the Income Tax Law is not within the power granted by the Sixteenth Amendment, this basis of discrimination between corporations is not reasonable and within the adjudicated principles of this Court on that subject. A classification which is unreasonable and founded upon no justifiable element of differentiation is not classification. If there be no true classification and there is a difference in the burden of taxation imposed, there is a case of a discriminating burden being laid upon one member of a class in favor of other members of the same class. That is not, as this Court has held, taxation, but confiscation. Universal is the agreement that arbitrary and unreasonable classification is a violation of the fundamental principles of taxation. Congress has power only to levy taxes. Aids and contributions to government levied in violation of this law of uniformity are not taxes, and cannot be levied by Congress.

It is not necessary from our point of view to argue the proposition that the Fifth Amendment to the Constitution, providing that property

shall not be taken without due process of law and that private property shall not be taken for public use without just compensation, restrains the power of taxation. It is enough for us to adhere to the proposition that a discriminatory burden of taxation placed upon one member of a class that operates for the benefit of the other members of the same class, being not taxation but confiscation, is forbidden by the operation of the Fifth Amendment. It certainly is taking property without due process of law and taking private property for public use without compensation for Congress to confiscate property, even under the guise of the exercise of the power of taxation, when the act complained of is recognized as not being valid exercise of that power.

I do not think it is necessary to call the attention of this court to its repeated utterances to the effect that there is a certain uniformity in connection with matters of taxation that is fundamental, and the want of which takes the action of Congress out of the region of the exercise of the power of taxation. The recent case of *Southern Railway Company* v. *Greene*, and the dissenting opinions of Justices Harlan and Brewer in the *Pollock* case furnish some of the instances of the enunciation of this principle. It is admitted by the Government's brief. The pertinent inquiry always is whether the distinction and classification is a sound and a reasonable one so as to result in the formation of different classes, or whether it is merely a disguise for a selection of an individual or a class to bear an excessive burden. Viewing the corporations of the United States, then, as a whole, without reference to the business in which they are engaged—taking them as a bulk engaged in all the varied activities of corporate life—what reason for distinction is there between one holding stock in another corporation and one which does not? If there be a privilege or advantage in such holding, it is granted by the state of crea-

tion. If this privilege be regarded as a franchise that is the subject of taxation by the operation of the Income Tax Law, then do we have not an income tax but a direct tax without apportionment upon this privilege or franchise granted by the state. But there is no essential difference in the operations of corporations holding stock in other corporations and those who do not.

A corporation as a stockholder of another draws its dividends and exercises its rights as a stockholder, but the exercise of those rights in no way affects the exercise by it of its own corporate franchises and powers or its methods of business in compliance with the laws of the state of its creation. Nor can there be any difference in their relations as stockholders between a corporation as a stockholder of another and an individual as a stockholder of a corporation. Nor is there any difference in the status of an individual who owns stock in a holding corporation and one who holds stock in a non-holding corporation. There is no fact, circumstance or incident that can be suggested as a basis of this classification, except the mere fact that a corporation and not an individual is the stockholder of the other corporation. Now, this fact has no relation to any power that can properly be exercised by Congress. Congress has no right of regulation over the holding of stock in one corporation by another, unless that corporation be engaged in interstate commerce or in the exercise of some power the regulation of which is committed to Congress by the Constitution. Generally speaking, the right to hold stock in another corporation being subject to regulation only by the state of creation of the corporation, a discrimination for purposes of taxation between corporations and between individuals and corporations based solely upon the incident of one corporation holding stock in another necessarily is an interference by Congress with the right of regulation of its corporations by

the state of creation, which is exclusively a matter within the power of that state.

Corporations, in their relation to income, are mere instrumentalities for getting income together and distributing it among those beneficially interested. On no other theory can the discrimination between corporations and individuals in respect to the surtax be justified. This view is recognized in the exemption in the hands of individuals of dividends received from corporations who have necessarily already paid a tax of one per cent. upon their net earnings. Therefore, the discrimination against holding companies is finally a discrimination against stockholders of such companies in favor of stockholders of non-holding companies.

Collection at the Source.

Our claim is that the imposition upon corporations, fiduciaries, employers and debtors of the necessity, at great expense and effort to themselves, of acting as assessors and collectors for the Government, involves the taking of property for public use without compensation.

I would not be understood as taking the position that the Government cannot require corporations and others to assist it in the collection of taxes, but that this burden should be accompanied by proper compensation for the labor and the expense that they are called upon to perform in collecting income taxes at the source.

That duty is not a common law duty. It has no relation to the duties which citizens can be asked to perform for the Government, like military service or jury service or as members of a *posse comitatus.* Corporations and others are called upon to hire clerks, to go to the expense of legal advice, to determine which of the forty-three different forms, issued by the Treasury Department, they must use

in connection with these matters, to look after certificates of ownership and of exemption and, in the case of the Union Pacific Company the bill alleges, and it is admitted by the demurrer, that the annual expense will be at least from $5,000 to $10,000, in performing these services for the Government.

That labor and that expense are taken from the defendant corporation, and taken from its resources for public use, not in performance of any duty which the government has a right to exact, and we present a case of taking private property for public use without compensation.

While the expense of all this to the Union Pacific is at least from $5,000 to $10,000 annually, there are many companies to which it involves the expense of $20,000, $25,000 or $30,000, and I hope that the curiosity of the Court will be sufficiently excited to read a very interesting extract copied into my brief from the remarks of a gentleman who has made a study of the matter.

It is not left to the option of the corporation as to whether it should pay a tax on coupons. It must retain and pay it when the bondholder does not claim an exemption from tax, and there is no requirement of law that he shall claim to the debtor the exemption when he is entitled to it.

I would call attention to the provisions of the law, because the law requires the corporation, in every case, even where the amount of payment is less than $3,000, to deduct the tax when it pays the coupons and registered interest, and pay it over to the Government, unless the bondholder files with the corporation a certificate of claim of exemption. While the bondholder must file a certificate of ownership, he need not claim exemption unless he chooses so to do. The corporation has no means of compelling the bondholder to file that certificate of exemption with it, and one of the consequences of

which we complain is that the Government gets a large amount of taxes from this corporation with respect to bondholders, who really are exempt, but the corporation does not know the bondholders are exempt, and never does know, and the Government gets the money to which it is entitled and the corporation loses it.

While the man who pays it, or for whose account it is paid, has a right to its return, if he is exempt, we can have no relief if he does not choose to tell us he is exempt. In a case like this where the Union Pacific has covenanted that it will pay the Government any tax which it is required to withhold (it is a contract, of course, only between the bondholder and the company, the Government has nothing to do with that), in conformity with its contract with the bondholder, the Union Pacific has to withhold the tax and pay it to the Government, both of which acts are required by the statute. It is no concern of the bondholder to inform us that he is exempt. Even if he be exempt he loses nothing.

The contract between the company and the bondholder only requires it to pay the coupon without deduction of the tax. The onus of paying the Government is put on it by the Act of Congress, not by our contract with the bondholder.

The bondholder does not communicate with the Company at all as to his exemption unless he wishes to. He does not have to.

That is the point, the tariff law places no obligation upon the bondholder, when he is exempt, to claim the exemption from the corporation.

The Union Pacific has to deduct the tax from its coupons, and to pay the tax to the Government.

If you have Union Pacific bonds with a tax-free covenant, you are not bound to do anything about the claim for exemption at all, but you may let the Union Pacific pay the tax, and if you happen to be exempt, the Union Pacific has to whistle for its

money. The bondholder need only file a certificate of ownership with the Union Pacific.

If the bondholder is exempt there is a right to get the money back, but the company has no means of knowing whether or not the bondholder is exempt.

The Union Pacific has to pay the bondholder's tax to the Government in every case where it cannot produce a certificate from the bondholder claiming exemption.

The law requires this.

If it does not, it is liable to a penalty of from $20 to $1,000.

I mean to say that the Union Pacific in this case of an exempt bondholder, who does not claim exemption, pays the tax to the Government and to the bondholder also.

The Union Pacific does not agree to pay the tax, it only agrees to pay the bondholder his full coupon. The Statute requires the company to pay the tax if the bondholder does not claim exemption.

The bondholder may be exempt from tax and not notify the company.

The Union Pacific, by the law, is obliged to pay the tax, and if the bondholder is not courteous enough to file his certificate of exemption, he is not obliged to.

There are in effect two certificates that have to be made in connection with this matter. Every time a coupon is passed in there has to be a certificate of ownership of the coupon, but if the bondholder claims an exemption at the source, then there is a second certificate claiming the exemption. These two certificates are printed upon one form, but the bondholder can draw his pen through the part relating to exemption; also he might be exempt, and yet not claim exemption. The certificate as printed by the Treasury Department does not state a fact as

to exemption, only a claim. The statute does not require a bondholder to claim exemption.

But the point of the matter is this, that while this extraordinary result of the operation of the act is most oppressive and drastic and unjustly takes private property for public use, it really does not bear upon the merits of the proposition at all, that the labor of assisting the collection of taxes for the Government is taking private property for public use without compensation.

In this connection I call attention to the cases on my brief, especially to the case in 178 Alabama, where it was held that the taking of a man's plow horses, wagons and mules for work on the highways, was taking private property for public use without compensation.

Really, the labor of the Union Pacific is comparatively small to what some of the trust companies have been compelled to perform, whose bills of expense run up into many thousands of dollars.

In no previous case connected with collection at the source was any constitutional question raised in opposition to its validity.

Collection at the source cannot be defended as an exercise of the police power of the United States, which can only be exercised to promote the health, comfort, safety or welfare of the community in connection with some matter as to which Congress has a right to legislate.

Unapportioned compulsory service is not a tax. First, it is not definite and generally imposed upon all of a class with substantial equality upon all members of that class; second, collection at the source is a burden of labor and not a pecuniary burden; third, collection at the source does not fall within any of the recognized duties of a citizen such as military, jury or fire duty or service as a member of a posse. Previous cases dealing with collection at the source do not present the ques-

tion that compensation should be made for the labor exacted.

Enforced labor by legislative enactment without compensation is an unconstitutional taking of property (see authorities at p. 52 *et seq.* of brief).

The property of a corporation is taken for public use and without compensation when the inevitable operation of statute in addition to the imposition of large expense in collecting for the Government taxes of third persons, is either to compel the corporation to pay taxes that are not lawfully due or to conduct an expensive and inquisitorial investigation into the private affairs of third persons.

The Act involves unreasonable discrimination and arbitrary classification resulting from the practice of collection at the source:

First, between corporations who are indebted upon bonds and those who are not;

Second, upon corporations who have funded their debts in favor of corporations whose indebtedness is of a floating character, with interest not payable at fixed periods;

Third, between individuals who are debtors, fiduciaries or employers and those who do not occupy those relations.

Fourth, between individuals who have invested in bonds and those who have not.

Such discriminations are unwarranted and not within the grant of power given by the Sixteenth Amendment, and are also unreasonable in their nature. An effect of the discrimination between individuals who have investments in bonds of corporations and those who have not such investments is that the bondholders are deprived of the use and benefit of the moneys withheld to pay their taxes during the period of time between the date of the

withholding and the date of the payment of the tax.

It is admitted that Congress may provide for collection at the source, provided due compensation is made to those who furnish labor and money to the Government in the assessment and collection of the tax. The present provisions of the Income Tax Law make no provision for such compensation and are therefore invalid as violative of the Fifth Amendment.

RETROSPECTIVE TAXATION:

The statute is invalid in the particular of seeking to tax income received prior to October 3rd, 1913.

Your Honors will bear in mind the dates. The Constitutional Amendment was passed on the first of March, 1913. The law was not passed until the 3rd of October, and the law attempts to be retrospective by requiring a tax-payer to make a return of all his income received from the 1st of March, 1913, and to pay the tax thereon.

Our suggestion is that until Congress exercised the power which was conferred upon it by the 16th Amendment, that power lay dormant, and that income received was not affected by the element of taxability without apportionment until the Act was passed on the 3rd of October, and further that income that has ceased to be income is not income for the purposes of taxation.

The statute provides, as the amendment provides, that the tax is to be upon the income, but what had been received prior to the 3rd of October, 1913, while it was income when it was received, ceased to be income the moment it was received. It came into a corporation's treasury or a man's pocketbook, and it was instantly dissolved and became capital the moment it was received. Therefore, on October 3, 1913, while income from that time on was subject

to taxation, income received prior to that time was not then income.

The act, we claim, is invalid so far as it seeks to tax income received between the first of March and the third of October, the date when incomes were made subject to taxation by the action of the Congress.

Income is either money or it is a credit owing from some third person, and immediately passes into some form of property when it is received, or is spent and passes away.

Whatever had been received when Congress taxed incomes on the third day of October, was on the third of October property,—property into which the income had passed, unless it had been expended and vanished. What was previously received becoming property when received, was no longer income; the unexpended portion had remained property; and therefore an attempt to tax the receipts prior to October third was in effect an imposition of a direct tax upon property without apportionment.

There seems to be no escape from the proposition that the tax upon incomes received from March 1st to October 3d, 1913, is a direct tax without apportionment, upon the real and personal property representing that income as a conclusion from previous decisions of this court with respect to the dormant character of powers of Congress that have not been exercised. It is not expected that this court will hold that the Sixteenth Amendment was self-executory and imposed a tax without apportionment from the 1st of March, 1913, upon the incomes generally of real and personal property within the borders of the United States. The Sixteenth Amendment must be read in connection with subdivision 4, Section IX, Article 1 of the Constitution. "No capitation or other direct tax shall be laid unless in proportion to the census or enumeration, &c."

The distinctive characteristic of subjection to taxation was laid upon incomes only when taxation was levied upon them by the Act of October 3d, 1913, and therefore incomes prior to that date were exempt from retrospective taxation by the power of Congress. If this be not so, there would never be any limitation upon the length of time that Congress could go back and tax the incomes received within the United States. Why could not Congress at some future time impose a tax upon the incomes received during the ten years previous to the enactment of the law? Many fortunes of the present day have been entirely built up by savings out of income received during the last, we will say, ten or fifteen years. If Congress could impose a tax upon incomes received during the last ten years, a very large part of what is now the principal of accumulated wealth could be swept into the treasury as income taxes.

Income received prior to October 3d was then free from taxation and free from service as a measure of value of property for the purpose of taxation without apportionment, and the property producing it was free from taxation measured by its income without apportionment and the property or capital into which it had been transformed was equally free from taxation without apportionment. Whatever view be taken of the subject that bears the incidence of the taxation of income received prior to October 3, 1913, that burden could not be imposed by legislation enacted subsequently to its receipt.

Income can only be income once, and that is at the moment of its receipt. Before that moment it is a mere expectation; afterwards it is an increment to capital. It is merged into the general mass of capital, unless it has been spent, and then it ceases to exist as income or anything else. Therefore, a power to tax income can be exercised only by

making it taxable at the moment when it comes in. If the element of subjection to taxation does not adhere to income at the moment of receipt, it never can. Any taxation based upon income previously received is necessarily a taxation either of the property producing the income, or of the property into which the income has passed, and such taxation could not be levied by Congress and made operative retrospectively by the act of October 3, 1913, without apportionment.

The thought that the powers of the Congress may lie dormant until they are exerted was set forth by Chief Justice Marshall in the case of Sturges *vs.* Crowinshield, where the question arose as to whether the State had power to pass an insolvency law provided there was no existing law of Congress on the subject, the Constitution having given the Congress power to pass statutes with reference to bankruptcy; and Chief Justice Marshall said:

"But be this as it may, the power granted to Congress may be exercised or declined as the wisdom of that body shall decide. If in the opinion of Congress uniform laws concerning bankruptcies ought not to be established, it does not follow that partial laws may not exist or that State legislation on the subject must cease. It is not the mere existence of the power but its exercise which is incompatible with the exercise of the same power by the States."

Therefore, it was not the existence of the right to legislate; but it was the act of legislation which for the first time impressed a tax upon incomes. Up to that time the power lay dormant.

I do not advance that as a general proposition retrospective taxation of property is not valid, but I am dealing only with this particular kind of a tax, this income tax without apportionment which was permitted for the first time by the 16th

Amendment to the Constitution. That is the point. Here we have a tax authorized to be laid by Congress on incomes, that was not in fact laid until October 3d, 1913, after that upon which it was laid had ceased to be income.

So far as the income had not been spent on Octo- 3d, 1913, it was property, and the retrospective tax fell upon that property directly without apportionment. So far as the income had been spent, it had ceased to exist on October 3d, 1913. A tax upon spent income is a tax not upon income but upon expenditure. Therefore, a power to tax income can be exercised only by making it subject to taxation at the moment when it comes in, or by laying a tax in anticipation of its coming in that will render it subject to taxation at the moment of receipt.

Let us suppose that the tax was so important in amount that a man would contemplate economy in view of the tax; but he could not have known anything about any tax before the third of October, 1913, after he had spent his income without anticipating any tax.

Suppose the normal tax had been ten per cent.; that would have been a real hardship to many people who followed the course of spending their income as they got it.

I will say only one word on the Stockdale case upon which the Government very much relies. That was a case in which under the old income tax law of 1864 the Court sustained an act which construed a former act, and which had the effect of retrospective legislation on the subject of income taxation; but in that case we did not have this question of direct taxation without apportionment. That question was not raised at that time. It was not discussed; and had that been in the way, I think the decision would have been a very different one, because the moment you go back of the third of October, 1913, you are putting a direct tax upon

property, and that direct tax prior to the passage of the act by Congress could not be levied without apportionment.

No direct tax can now be levied by Congress without apportionment, except upon incomes, unless a very broad construction of the Sixteenth Amendment be adopted, that will permit Congress to levy any direct tax upon any specific property at any rate, in the guise of an income tax upon the income of that property. The concession of the general power of classification as to income taxes involves this result.

This contemplated result accentuates my claim, that the door was only opened by the Sixteenth Amendment, on a crack, so to speak, and that the only thing allowed to be levied without apportionment is a direct tax upon incomes—that is a tax upon incomes as a whole and in bulk.

If there were no provision of any kind in the Constitution for apportionment of direct taxes, and power to lay an income tax was in Congress, and if Congress should pass an income tax and make it retroactive for a reasonable time, two or three months, and fix the date upon which it should be operative, such an act would not be void on the ground that it was not the exercise of a power to levy an income tax. As a tax upon income is a direct tax upon the property that produces the income, or into which the income has gone, and as Congress would in that case have power to impose a retroactive tax upon property, if there were no apportionment restriction, such a retroactive tax upon income would be valid.

But looking at the actual situation before October third, the apportionment provision stands in the way of any such retroactive tax on property without apportionment under the guise of an income tax. If you have not any apportionment provision, nothing stands in the way.

The tax upon income received before and after

October 3d, 1913, is equally a property tax under the Pollock decision. Before October 3d it must be apportioned to be valid, after that date it need not be apportioned.

Even if it be conceded, for the sake of the argument at this point, although we dispute it, that when Congress came to confer upon the Government of the United States by the 16th Amendment to the Constitution the power to levy an income tax, they intended to convey to that Government the fullest conception of the income tax power, divested of and unlimited by the difficulties in the Constitution concerning apportionment, and to except from it as a limitation the income taxing power which is conferred, there would still remain the question whether that which was received by the recipients before October third was income when the act was passed This supposed broad income taxing power is still limited by the necessity of directly taxing not otherwise than with apportionment, the property really taxed through the taxation of income and that which had been income when Congress acted by legislating on October 3d, 1913.

My point largely goes to the meaning of the word income as used in the Amendment, but not entirely. That meaning must be taken in connection with the view of the Pollack case that it is property that is being taxed when income is apparently and in so many words taxed. The question must be met whether income in the Amendment means what has been income or what is income at and subsequently to the time the tax is levied by the Act of October 3d, 1913.

There is no escape from that, absolutely; and I urge that what has been received prior to the passage of the act, when the act is passed is no longer income. It has become capital. The moment it was received it became capital, and stopped being

income. It was received without the element of subjection to taxation. The hand of Congress had not been laid upon it.

I do not recall whether our Congress has ever passed laws imposing import taxes relating back to a period prior to the date of the enactment. It has been done in England.

But there is no question of apportionment there, because such laws provide for excises. Congress may go back and levy customs retrospectively.

Corporate Indebtedness.

In the case of the Tyee Company there is the question of indebtedness, and I have referred to that already. It is evident that a discrimination is made by the provision of the law, that a corporation in ascertaining its indebtedness cannot deduct interest on indebtedness in excess of interest on an amount equal to the sum of one-half of its indebtedness plus the par value of its capital stock, between members of the same class, between corporations having an indebtedness one-half of which is equal to or less than their capital, and those one-half of whose indebtedness is greater than their capital stock. I will spend no more time on that, as it is sufficiently covered in our brief.

Surtax.

The case of Thorne involves the validity of the surtax. The complaint alleges that his normal tax was a certain amount—a very small amount—and the remainder was an additional tax levied upon him because his income exceeded $20,000 per year.

I will only have time to call the attention of the court to certain facts connected with the income tax. They are set forth in my brief at pages, 6, 7 and 8. I assume your Honors are familiar with the provisions relative to the surtax, but let me say

that the computation shows that the results of the discriminations created by the income tax are such that the normal tax upon a man who has an income of $20,000 is less than one per cent., because he has an allowance of $3,000 and, therefore, pays one per cent. on only $17,000.

A man who has an income of $50,000 pays a tax that is equal to about 1-6/10 per cent. of his entire income.

A man who has an income of $75,000 pays a tax of two per cent. of his entire income.

A man who has an income of $100,000 pays a tax of two and one-half per cent. of his entire income.

A man whose income is $250,000 pays a tax of four per cent. of his entire income.

When a man has an income of $500,000 he pays a tax of five per cent

When his income is over $500,000 he pays six per cent. on his entire income.

If a man has an income of $1,000,000 he pays six per cent. on his entire income as a tax.

If his income is over $1,000,000 the percentage of tax increases until it reaches about seven per cent.

Those certainly are discriminations and classifications between members of the same class. It is not discrimination between classes, unless we come to the conclusion that classification by reason of wealth alone, the circumstances of the individuals being otherwise the same, is on a proper basis for the purposes of taxation.

When the Income Tax Act was enacted it was supposed that 500,000 persons would be liable to pay a tax under its provisions. Of this number 456,500 persons were expected to pay a tax on $20,000 and under and 43,500 on over $20,000 in the way of income. In other words, 8.7 per cent. of the taxpayers would pay a super-tax on incomes over $20,000 and 83-1/2 per cent. of the entire revenue to be derived from the Income Tax Law would come from those

liable for the super-tax. This was the estimate publicly announced in Congress as the expectation of the operation of the tax.

As a matter of fact, the realization did not exactly correspond to the expectation and the percentages resulting from the collection of the tax for the ten months of 1913 differed from the statements made in Congress. The returns for 1913 were from 357,500 individuals. Those possessed of incomes over $20,000 paid in surtax 55 per cent. of the entire tax, besides paying their normal tax of 1 per cent. 334,423 individuals paid tax on $20,000 of income and less, while 23,175 persons paid 55 per cent. of the entire tax, besides paying their normal tax of 1 per cent. The results of the collection of the income tax for 1914 were that those possessed of incomes over $20,000 paid in surtax over 67 per cent. of the entire tax, besides paying their normal tax of 1 per cent.

As a general proposition, however, it can be stated that the results of the operation of the Income Tax Law substantially justified the anticipation. Certainly the result shows that for the year 1913 about 7 per cent. of the taxpayers paid in surtax 55 per cent. of the entire tax, besides paying their normal tax of 1 per cent. Generally speaking, therefore, it appears that far the larger part of the income tax is paid by comparatively few individuals through the exaction from them of the surtax.

These inequalities, of course, can only be justified by a defense of the classification on the basis of wealth as involving some principle that makes that classification reasonable and not arbitrary. Indeed, if we examine the writings of the advocates of progressive taxation we find, that the frank admission is made, that progressive taxation is to be adopted, not so much by reason of the necessities of the government for revenue, as, the advisability of bringing

about a distribution of fortunes and discouraging the accumulation of excessive wealth.

The true reason for this classification seems to be the supposed advantage to the State in discouraging the possession of large fortunes. Such a reason seems to be of the same quality as that which lay at the back of the action of the English Parliament in 1691 when Protestants were taxed at a certain rate, Catholics as a class at double the rate of Protestants, and Jews at another and separate rate. But the mere fact that such a reason existed for making this discrimination does not and will not satisfy this court without inquiry into the reasonableness of the reason.

The case of *Knowlton* vs. *Moore*, as I read and understand it, was put upon the proposition that there was a difference between inheritance taxes and property taxes for purposes of taxation and that in connection with questions of taxation, they were distinct. I had not supposed that the decision in that case was put upon the ground that it was within the power of our government to consider the amount taxed in fixing the rate of taxation.

I know that the opinion speaks of the fact that many economical writers consider that the basis of paying taxes according to a man's ability to pay is perhaps a fair way of considering the question of rate of taxation and of classification according to wealth. I had not supposed that the case was decided upon grounds that committed this Court to that proposition. It is that very theory that I venture to suggest to the court is not a fair, reasonable basis for classification.

On the contrary, so far as the weight of evidence goes with respect to economical writers, it is not accepted as a cardinal and sound doctrine of taxation. Much proof of this is contained in our brief. Of course progressive, graduated taxation has been known in various periods of the world's history. It

was known in the Middle Ages, in the Florentine Republic, when after a certain amount, the graduation was carried to a point where the entire income was confiscated. It was known in France in 1794, when an act was passed that all amounts above 9,000 livres should be taxed 100 per cent. and the entire income thus go to the State.

Nor are we without those in this country who are in power and look forward to such a result. During the debate in the Senate upon this Act, a leading Senator expressed the view, that he hoped that some day the time would come when all taxes for the government would be raised by taxing the citizens in proportion to their ability to pay, which simply means taking by way of taxation from the citizen, not his proportion of the expenses of the Goverment in relation to the protection that he and his property receive from the Government, but what is guessed to be his surplus wealth or income after a reasonable provision for his support.

It is a very curious fact in the history of progressive taxation, that in England it found a place in income taxes when the power rested in the hands of the large landholders and the men of wealth during the Napoleonic wars and in the early part of this century. They then had progressive taxation as a part of their income tax system in England. That is to say, the men who had the power recognized that they must take the burden. It was taxation with representation. They were represented to the point of domination in the government, and the extent of their representation was such that they accepted the burden of unequal taxation.

Then, when England grew to be more democratic, when the reform came about in 1832 and the "rotten boroughs" were swept away, graduated and progressive taxation began to lose approbation, and about 1845, I think, it disappeared, and from that time

to 1911 there was no graduated or progressive taxation of income in England. But as the mass of voters gained more power, then we see both in England and in this country, not now progressive taxation on the theory that the men who have the power are the ones who should bear the burden, but on the theory that the men who have the power and have not the wealth should lay the burden upon those who have not the power but have the wealth. In other words, we now have taxation without representation.

What is the effect of this opening wedge, so far as this country is concerned? The law places a tax upon the very wealthy, really for the benefit not only of those who have little, but of those who have a good deal but have not so much. I have called attention to the fact that the man who has an income of $20,000 pays a tax of $170 at the rate of less than one per cent, and that the man who has an income of $1,000,000 pays a tax of $69,000, at the rate of 6.9 per cent; and ordinarily speaking we would think that a man who had an income of $20,000, four per cent on $500,000, was a wealthy man.

So that what we have really got here, without speaking of the effect of the exemption of those comfortably off with an income of $4,000, which is four per cent. upon $100,000, is a law which taxes the very wealthy for the benefit of the wealthy.

The figures will show that with the present law, if there had been no surtax and if the normal rate had been increased from one to two per cent., just as much if not more money would have been raised than was collected by the operation of this surtax. These are facts that may well give rise to the consideration, is this a fair and a just and therefore reasonable classification? While the government contends that this question was decided by *Knowlton* v. *Moore*, I submit that the court in that case

took the view that inheritances had always been the subject of taxation from time immemorial; had always been recognized as clearly within the grasp of the taxing power; that the progressive feature was permitted by the State for the reason that the State had the regulation of inheritances and succession to property by will, and that by some kind of analogy, as long as the United States Government had this power to tax, although the Government had no right to regulate successions and inheritances, it should be held also to possess power to tax by progression. I think it is in the Magoun case that Judge Brewer in his opinion says that if this was a question of the taxation of property he would take an entirely different view of the question of progressive taxation and would hold it unreasonable and confiscatory. If this classification is to be sustained, it necessarily would follow that the whole subject, the whole field of taxation, is thrown open to Congress quite as fully as it is possessed even by the States that have no provision in their constitutions for uniformity and equality of taxation.

It would then be perfectly competent for Congress to enact a provision imposing a tax upon the income from improved real estate of five per cent., a tax of three per cent. upon the income from corporation bonds, and so on—different rates for different incomes upon different species of property. If that is what the 16th Amendment means, then, absolutely, the field of taxation is thrown open completely to Congress, just as completely as to any State, and Congress will have the power, of course, through the enactment of tax laws to control, regulate and even destroy every activity of every kind, corporate and individual, because, as appears from the case of *Veazie Bank* vs. *Fenno*, where Congress taxed State banks out of existence, it is no answer to say that the power to tax could not be exercised as a power

to destroy. It follows, that if the power to tax exists, of course, the power to destroy necessarily exists.

What is the basis of the discrimination by wealth? Simply a certain presumption that an individual who has a large income is better able to pay, is able to pay at a greater rate, than a man who has a smaller income. It is a pure assumption in the case of any individual that he feels a particular tax less than others, no matter what may be the size of his income. Nobody knows what are the calls upon any particular individual; nobody knows what the demands are upon him. He may have a very large income, and yet his relations to his family and to society, and his obligations, may be such that he would feel a tax more than a man with fewer calls and a much smaller income; and no real justice could be brought about except by a minute inquiry in the case of every single taxpayer, thus finding out how the tax fell upon him, and assessing him accordingly. That was done in Florence and in France, but it was found that it was impracticable in operation.

Does the Sixteenth Amendment sanction this method of taxation? Certainly not in terms. The plain and obvious meaning is that incomes are to be taxed uniformly and at the same rate and without discrimination. In the words of Mr. Justice Bradley in the *Legal Tender* cases, let us see how this Amendment is interpreted in the light of history and of the circumstances of the period in which it was framed. I contend that when the Sixteenth Amendment was adopted, what is termed "progression" in taxation was not recognized as part of the system of taxation in this country, either through taxation of incomes or through the form of a graduated tax upon property.

While it is true that some of the income tax laws passed during the time of the Civil War provided for progressive taxation, it is also true that there

never was any discussion of the constitutionality of these laws, while there was some litigation with reference to the mode of assessment and collection and upon the question whether the tax fell upon the individual taxholder or upon the corporation or source that was obliged to pay the tax. In that time of stress and storm the patriotic citizens were more concerned about financial ways and means to subdue opposition to the Union than to criticise the methods employed by taxation or otherwise. It is to be noted, however, that neither the Income Tax Law of 1894, which was declared invalid in the *Pollock* case, nor the corporation excise tax of 1909 made any provision for progressive taxation. So far as I have been able to ascertain, there was no discussion of the theory or idea of progressive taxation in connection with the adoption of the Sixteenth Amendment by the Houses of Congress or by the separate legislatures of the States. The possibility of that feature entering into the law was not presented until after the Sixteenth Amendment was adopted and until the discussions arose in Congress over the Tariff Law, and the happy thought was then brought forward that here was an opportunity under the forms of law to compel the payment unequally and without uniformity of a very large portion of the tax by a few individuals by the operation of unequal rates upon them formulated in connection with the respective amounts of their incomes. All the agitation that was for the Sixteenth Amendment was to overcome the effect of the decision in the *Pollock* case, by which the imposition of a general and universal income tax derived from the employment of real and personal property was prohibited without apportionment.

In view of the decision in the Pollock case that a tax upon the income of real and personal property is a direct tax upon that property itself, if this pro-

gressive income tax be constitutional in the sense that it is taxation and not arbitrary classification, not confiscation, not prohibited as a denial of the equal protection of the laws and due process of law, not the taking of private property for public use without compensation, then there is nothing to prevent Congress from imposing a direct tax upon real or personal property without apportionment, graduated and progressive with respect to the different values of the same kind of property through the guise of a tax upon the incomes of the selected properties.

The unreasonableness of the classification based upon wealth is evident because of the consequent and necessarily discouraging effects upon thrift of the adoption of such a rule. In the best sense it is undemocratic, because it tends to release the many from their fair share of the burdens of government and places the many in the positively immoral position of receiving at the expense of others the benefits of government to which they themselves do not contribute. It is only democratic in the worst sense in that it involves the exercise of the power of the many to take unequally from the few for the benefit of the many.

The only safe and sane rule, and, therefore, reasonable rule of classification is to impose an equal rate of taxation upon property of the same character and subject it to equality of burden.

The history of progressive taxation in this country is that where it is intended to be allowed by constitutional provisions the power is distinctly conferred. The State of Wisconsin and the State of South Carolina authorize by constitutional provision progressive taxation. The absence of such express authorization in the Sixteenth Amendment indicates that the feature of the statute permitting it is not within the power of Congress.

Argument in Reply.

Mr. Davies: May it please the Court, first let me take up the question of jurisdiction that has been raised by the government in the Brushaber case against the Union Pacific Company. The stress of that objection seems to be that the directors of the corporation are to be presumed to have exercised some discretion, in refraining from doing what the stockholders think they should have done, and that it is not for the Court to deal with the question of the propriety of the action of the directors.

I understand that the position of the government in this case is to intervene as *amicus curiæ* to protect the interests of the government in connection with the questions of taxation. I do not understand that the government here represents the Union Pacific Railroad Company or the directors of the Union Pacific Railroad Company in regard to their relations with their stockholder; and when the company itself, and the directors, do not appear here to say that they thought it was bad business judgment not to make returns and not pay the taxes of third persons and the Company's taxes in part, and that they thought it was good business judgment to make the returns for the bondholders, to withhold the taxes for the bondholders, to go to all the necessary labor and expense in connection with the withholding of the tax and paying the tax on the coupons, when the directors themselves do not come here and defend their action, it seems to me it is not for the government or anybody else to suggest that they are qualified to represent the directors and to speak for them.

The Union Pacific Railroad Company has filed a brief in the case, in which it has said only that so far as the questions raised and connected with the validity of the law are concerned, the government hav-

ing been notified of the pendency of the case, all of those questions have been left in the hands of the government. The fact that there is no position on the subject here taken by the company and by the directors seems to leave out of the discussion of this case the question as to what reasons are to be assumed to have governed the directors in going forward and doing what the stockholder asked them not to do and sought to enjoin them from voluntarily doing; and if your Honors will read the letter that is attached to the bill of complaint, that the board of directors of the Union Pacific Company wrote to the complaining stockholder, when the demand was made of the board of directors to take action, your Honors will see that the only reason assigned by the directors was that they did not wish to incur the enormous penalties which the income tax law provided should be imposed upon them if they failed to comply with its provisions. For that reason, and for that reason alone, the directors went forward and did what we asked them not to do.

I would say that the Corbus case is no authority on this question, because it went off on the point that the bill did not show that any demand had been made on the directors to take action before the stockholder filed his bill. The allegations in our bill are complete in that regard, and show that in compliance with the equity rule, the complaining stockholder made a demand of the directors to take action, that there was an emphatic refusal of the directors to act and that there was an utter impossibility of getting the stockholders to act.

I would also further call the attention of the Court to the fact that the practice pursued and the filing of this bill was in accordance with what seems to have been the established practice in this court in connection with similar cases, originating with the case of *Dodge* vs. *Woolsey*. The taxation questions were presented by a similar bill in the Pollock case

and in the *Flint* vs. *Stone Tracy* cases. Eight or ten cases came before this court in connection with the corporation excise law of 1909, and without objection precisely this method was pursued of bringing before the Court the questions of law that were involved in the act that was then assailed. Again, I would say that whatever has been said on that subject is no answer whatever to the right of the stockholder to maintain this bill to restrain the directors from going to the annual expense of $5,000 or $10,000, and thus wasting the assets of the corporation in complying with the invalid requirements of the law in assessing and collecting the taxes of third persons. Nor do I think there has been any answer on the part of the Government to the proposition that the requirements of the law upon corporations, fiduciaries, employers and debtors in calling upon them to assume these onerous duties, and go to these large expenses in acting as assessor and collector for the Government, involve the taking of private property of the corporations and the fiduciaries and other persons, for public use without compensation. All that has been said upon that subject is that such requirements have been contained in former laws, and that they never have been condemned by this court, although never questioned, and that the convenience of the Government is served by conscripting corporations and individuals to serve as collectors at the source.

An examination of the cases in which there has been discussion connected with the collection at the source, in the federal courts, will show that in no case was the proposition ever presented to this court that is presented in this case; in no case did that question arise. There is no ruling upon the proposition that this law in laying the heavy burden of labor and expense upon corporations and individuals in connection with the assessment and collection of taxes of third parties takes private property without

due process of law and for public use without compensation.

I have made no suggestion that the law has not a right to compel the taxpayer to perform a duty in connection with the payment of his own taxes. I have made no suggestion that the government cannot compel corporations, employers, debtors and fiduciaries to perform these duties if compensation is allowed to them, but it is a fact that this burden that is placed upon the business corporations, the trust companies, the banks, the fiduciaries, and trustees and employers of the country, is a load which amounts to hundreds of thousands of dollars annually in expenditures throughout the United States, imposed upon these persons to assess and collect taxes of third persons, without compensation. That is the gist of my complaint. Let compensation be made, and the work can be required.

It is true that under the practical operation of this act individual citizens are required to make returns who are not subject to any tax.

This is true not only of trustees or fiduciaries or employers, but also in some cases, individual citizens, whose incomes are greater than $3,000 or $4,000 if married.

If the individual has more than $3,000 he must make a return.

If a married man whose wife has no income has an income of more than $3,000 and less than $4,000, he has to make a return, and he has to show that he is entitled to a reduction of $4,000, and, that he has not to pay any tax.

But if he is a single man or married man with less than $3,000, he does not have to make a return.

And if he has an income of $6,000 or $10,000, if you like, which is all derived from dividends received upon the stock of corporations, he has to make a return; but he gets a deduction from his income of these dividends, and has not to pay on that income.

So it is true that individual citizens have to make returns in some cases, although they are not subject to a tax under the act.

So it is also true that the class of fiduciaries, debtors, trustees and corporations is not the only class that is burdened with the duty of making returns in the absence of liability to the taxation required by the act itself.

But these facts furnish no argument adverse to the position I am now taking. In the case of the parties referred to, who must make returns although not liable to the tax, they are persons who come within the net in the sense that they would be liable to pay the tax if they had the necessary income, either in amount or kind. They are directly within the purview of the act, and are liable to the taxation imposed by the act, unless certain facts to be shown by them relieve them. They are not dealing with the subject simply in connection with the taxation of third persons, while free themselves from legal liability for the taxes connected with that taxation, except as that liability has been arbitrarily imposed by statute. It is their own taxation, their own property that is subject to the taxation and the necessity exists to make a return to escape taxation. I am speaking on behalf of those who have no relation to the taxation at all of the individuals with whom all this labor is connected, except as the government creates the relation. There is no civic duty on the part of you and me to assess and collect for the government taxes imposed upon third persons.

It is urged that Congress wants to get the income tax, and it would be almost impossible to collect it unless it was gathered in this way.

But the answer is that the convenience of the government in the collection of the income tax does not authorize it to take the property of citizens without compensation, for public use.

As a matter of fact the income tax can be collected without the burdensome provisions for collection at the source. It is merely a question of the government going to the necessary expense itself, or forcing its collectors at the source to bear that expense.

I wish to say just one word upon the question of discrimination. It is admitted in the government brief that there is a line beyond which classification cannot be carried by the government. The government brief speaks of that line as being drawn where the differences are said to be arbitrary and outrageous.

It is said that this court has never decided that it has the power to destroy an act of Congress which is not void under some constitutional limitation. It is said in the case of *Knowlton* vs. *Moore* that it would be time enough to decide whether there was any power to strike down an act of Congress without a constitutional limitation when some question affecting the powers of the government arose in a case in which it was necessarily presented for decision.

I urge that this case presents that question, and that the moment you get an act of Congress which is not within the power of levying taxes, such as the Tariff Act is, in the particulars pointed out, then the 5th Amendment operates. I do not argue for a moment that the 5th Amendment and due process of law restrain the exercise of the power of taxation. The thought upon that head is this, that when Congress acts under the guise of exercising the power of taxation, and goes beyond the line of levying taxes, wherever the court chooses to draw it, then has the citizen the protection of the 5th Amendment, and then is his property taken without due process of law. Valid exercise of the power of taxation is according to due process of law. When we get beyond that line which the court has again

and again referred to, we reach classifications that are not reasonable and which have no basis of true relation to the taxing power. Such classifications, this Court has many times held to be invalid. It has never required the classification objected to, to be outrageous, to be invalid. In the instance that we frequently hear used of the taxation of a man because he is red-headed, for there is no doubt whatever that a capitation tax based upon that circumstance would be said by this court to be invalid, we have a case when the individual has the protection of the 5th Amendment.

May it please the court, we are redheaded. These clients I represent here are in that class. The discrimination is made against us by reason of the fact that we have not capital stock of par value equal to one-half of our indebtedness, the discrimination is made against us that we should pay two or three times the government's tax because the corporation owns stock in another corporation and that corporation owns stock in still another corporation. This additional taxation comes on the individual stockholders, eventually, and there is a discrimination between individuals whose capital is invested in stock in these corporations, and individuals who do not own such stock; and whose capital is otherwise invested.

The Assistant Attorney General made an illustration that admitted the very discriminations of which I am speaking. He spoke of the unjust discrimination that would arise among individuals, from the imposition of a surtax on a corporation when the surtax was also imposed upon the individual. He said that that would be an unjust discrimination against individuals who owned stock in a corporation that had to pay a surtax. That kind of discrimination is the very one I am endeavoring to bring before the court here in connection with these individuals who owned stock in a cor-

poration which has to pay a normal tax upon dividends received upon the stock of another corporation and an individual whose income is entirely derived from a corporation that owns no stock in another corporation. The discriminations I have pointed out in connection with those matters I sincerely submit to the court are unreasonable, they are based upon no substantial difference, not even the difference between the kinds of businesses that the corporations are carrying on; and of course the *Flint* vs. *Tracy* case, which was decided on the proposition that the corporation tax of 1909 taxed simply the doing of business in a corporate capacity has nothing to do with these questions.

An examination of the income tax law of 1894 will show that two of these matters that I have spoken of were allowed in that law: that is to say, that a corporation could take out all the interest upon all its indebtedness in arriving at its net income, and also that a corporation was not taxed on dividends received from other corporations.

The entire assessment of income tax against the three defendants for the year 1913 is invalidated by the inclusion therein of the amounts improperly assessed as income received between March 1st, 1913, and October 3d, 1913.

Where an assessment rests in part upon a subject over which the assessing authority had no jurisdiction, or where the tax is levied in part for an illegal purpose and no method appears whereby the legal element can be separated from that which is illegal, the whole tax or the whole assessment, as the case may be, is void. In the three cases argued together, the Commissioner made an assessment upon the income of the defendant, Union Pacific Railroad Company, and upon the incomes of the Tyee Realty Company and Edwin Thorne for the whole period of ten months from March 1st, 1913, to December 31st, 1913, without distinguishing in the as-

sessment between the period preceding and that following October 3d, 1913, and without any evidence as to the receipt of income by the taxpayers after October 3d, 1913. In each case there is an allegation that a large part of the income assessed was received before October 3d, 1913. This, we submit, makes the entire assessments for the year 1913 void, and the collection of the taxes invalid.

I would respectfully call attention to the briefs filed, and state that I stand upon all the arguments and authorities therein set forth, although I have been able to present *orally* to the Court only a small part of them.

Supreme Court of the United States,

OCTOBER TERM, 1915.

No. 140.

FRANK R. BRUSHABER,
Appellant,

vs.

UNION PACIFIC RAILROAD COMPANY,
Appellee.

APPEAL FROM UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

MEMORANDUM FOR APPELLEE.

The appellant, a stockholder of the appellee, instituted this suit, without invitation or encouragement from the appellee, to test the constitutionality of the income tax law (Act of October 3, 1913; 38 Stats., 166). As the only

issue is the validity of the obligations, sought to be imposed by the income tax law on the appellee, to pay taxes on its corporate income and to withhold, report and account for taxes on disbursements made by it supposed to constitute income of others, notice of the institution of the suit was given to the Attorney General with the request that he conduct the defense in view of the primary interest of the Government in the issue. The Attorney General having undertaken to appear and represent in this Court the interests of the Government, it is considered that the appellee is relieved of any obligation to defend the statute and it therefore makes no separate presentation of the case.

Respectfully submitted,

HENRY W. CLARK,

Counsel for Appellee.

October 7, 1915.

Office Supreme Court, U. S.
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INCOME-TAX CASES.

Nos. 140, 213, 359, 393, 394, 396.

In the Supreme Court of the United States.

OCTOBER TERM, 1915.

FRANK R. BRUSHABER, APPELLANT,

v.

UNION PACIFIC RAILROAD COMPANY.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

Also four other cases advanced for hearing with the preceding cases, viz:

JOHN F. DODGE AND HORACE E. DODGE, APPELLANTS, *v.* JAMES J. BRADY, COLLECTOR OF INTERNAL REVENUE;

JOHN R. STANTON, APPELLANT, *v.* BALTIC MINING COMPANY ET AL.;

TYEE REALTY CO., PLAINTIFF IN ERROR, *v.* CHAS. W. ANDERSON, COLLECTOR OF INTERNAL REVENUE;

EDWIN THORNE, PLAINTIFF IN ERROR, *v.* CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE;

and

JOHN F. DODGE AND HORACE E. DODGE, APPELLANTS, *v.* WILLIAM H. OSBORN, COMMISSIONER OF INTERNAL REVENUE, ON MOTION TO DISMISS OR AFFIRM.

BRIEF FOR THE UNITED STATES.

WASHINGTON: GOVERNMENT PRINTING OFFICE: 1915.

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In the Supreme Court of the United States.

OCTOBER TERM, 1915.

FRANK R. BRUSHABER, APPELLANT,
v.
UNION PACIFIC RAILROAD COMPANY. } No. 140.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

Also four other cases advanced for hearing with the preceding case, viz:

John F. Dodge and Horace E. Dodge, appellants, *v.* James J. Brady, collector of internal revenue; } No. 213.

John R. Stanton, appellant, *v.* Baltic Mining Company et al.; } No. 359.

Tyee Realty Co., plaintiff in error, *v.* Charles W. Anderson, collector of internal revenue; } No. 393.

Edwin Thorne, plaintiff in error, *v.* Charles W. Anderson, collector of internal revenue; } No. 394.

and

John F. Dodge and Horace E. Dodge, appellants, *v.* William H. Osborn, commissioner of internal revenue, on motion to dismiss or affirm. | No. 396.

BRIEF FOR THE UNITED STATES.

STATEMENT.

This brief is filed by leave of court in all of the above named cases. In two (No. 140, Brushaber, and No. 359, Stanton) the appearance is as *amicus curiæ*. In four (No. 140, Brushaber; No. 359, Stanton; and Nos. 313 and 396, the two Dodge cases) the jurisdiction of the court below is challenged. Independently of this jurisdictional feature, they all invite various questions affecting the constitutionality of section II of the act of Congress approved October 3, 1913 (38 Stat. 166, 181), known as the Income-Tax Act of 1913. This section is printed in full as an appendix to this brief.

Cases No. 395 (Tyee Realty Co.), No. 140 (Brushaber), and No. 359 (Stanton), involve corporation taxes; the others involve taxes of individuals. No. 395 involves a realty, No. 140 a railroad, and No. 359 a mining corporation. All three were organized for profit.

This brief will discuss under appropriate general headings every question deemed worthy of consideration that has been argued in any of the briefs

for appellants or plaintiffs in error, as if all the questions were presented in a single case. It will indicate as to each point discussed, the cases in which it is urged.

ARGUMENT.

JURISDICTION.

In No. 140 (Brushaber) and No. 359 (Stanton) a stockholder seeks to restrain the corporation taxpayer from voluntarily paying its tax. In Nos. 213 and 396 (the two Dodge cases) individual taxpayers seek to restrain the collection of their taxes; and the supplemental bill in No. 213, though filed after payment of the tax, was yet filed *before* any decision of the Commissioner on their appeal.

Division L of the Income-Tax Act of October 3, 1913, (38 Stat. 179) provides:

> * * * the laws in relation to the assessment, remission, collection, and refund of internal revenue taxes, not heretofore specifically repealed, and not inconsistent with the provisions of this section, are hereby extended and made applicable to all the provisions of this section and to the tax herein imposed.

Section 3224, R. S., provides:

> No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

Section 3226, R. S., provides:

> No suit shall be maintained in any court for the recovery of any internal * * * tax alleged to have been * * * *illegally* assessed or collected * * * until appeal shall have been duly made to the Commissioner of Internal Revenue * * * and a decision of the Commissioner has been had therein; * * * .

To avoid these statutes, in terms plainly forbidding these four suits, appellants claim (1) that if so read they would violate section 2, Article III, of the Constitution, reading:

> The judicial power shall extend to all cases in law and equity arising under * * * the laws of the United States; and * * * to controversies to which the United States shall be a party; * * *

and (2) that they do not apply where there is utter lack of jurisdiction to assess.

1. Sections 3224, R. S., and 3226, R. S., are constitutional.

Though in effect since 1867 and 1866, respectively, and often applied by courts, these sections are now for the first time assailed as unconstitutional. They but follow and complete the tax collecting procedure of the common law. Injunction was not used in England nor in the colonies to correct illegal taxation. Moreover, "judicial power" does not necessarily embrace tax controversies.

In *Murray's Lessee* v. *Hoboken L. & I. Co.*, 18 How. 272, 282, this court said:

> * * * it may be added, that probably there are few governments which do or can permit their claims for public taxes, either on the citizen or the officer employed for their collection or disbursement, to become subjects of judicial controversy, according to the course of the law of the land. Imperative necessity has forced a distinction between such claims and all others, which has sometimes been carried out by summary methods of proceeding, and sometimes by systems of fines and penalties, but always in some way observed and yielded to.

In *Nichols* v. *United States*, 7 Wall. 122, the court said:

> It would be impossible for it (the Government) to collect revenue for its support, without infinite embarrassment and delays, if it was subject to civil processes the same as a private person. (126.) * * * The allowing a suit at all, was an act of beneficence on the part of the Government. As it had confided to the Secretary of the Treasury the power of deciding in the first instance on the amount of duties demandable on any specific importation, so it could have made him the final arbiter in all disputes concerning the same. (127.)

See also *United States* v. *Pacific R. R.*, 4 Dillon 66.

2. These procedural statutes apply to any tax, however illegal and however the illegality may arise.

Though the assessment be under a law that may be ultimately held invalid, a tax levied by officers according to its mandate would be one levied under color of office and its collection could not be restrained.

In *Snyder* v. *Marks,* 109 U. S. 189, this court said:

> Hence, when, on the addition to the section, a "tax" was spoken of, it meant that which is in a condition to be collected as a tax and is claimed by the proper public officers to be a tax, although on the other side it is alleged to have been erroneously or illegally assessed. It has no other meaning in section 3224. There is therefore, no force in the suggestion that section 3224, in speaking of a "tax," means only a legal tax; and that an illegal tax is not a "tax" and so does not fall within the inhibition of the statute and the collection of it may be restrained. (192.) * * * The inhibition of 3224 applies to all assessments of taxes *made under color* of *their offices* by internal revenue officers charged with general jurisdiction of the subject of assessing taxes against tobacco manufacturers. The remedy of a suit to recover back the tax after it is paid is provided by statute, and a suit to restrain its collection is forbidden. The remedy so given is exclusive and no other remedy can be substituted for it. Such has been the current of

> decisions in the circuit courts of the United States, and we are satisfied it is a correct view of the law. (Citing cases.) In *Cheatham* v. *United States,* 92 U. S. 85, 88, and again in *State Railroad Tax Cases,* 92 U. S. 575, 613, it was said by this court that the system prescribed by the United States in regard to both customs duties and internal revenue taxes, of stringent measures, not judicial, to collect them, with appeals to specified tribunals, and suits to recover back moneys illegally exacted, was a system of corrective justice intended to be complete and enacted under the right belonging to the Government to prescribe the conditions on which it would subject itself to the judgment of the courts in the collection of its revenues. In the exercise of that right it declares by section 3224 that its officers shall not be enjoined from collecting the tax claimed to have been unjustly assessed when those officers, in the course of general jurisdiction over the subject matter in question, have made the assignment (assessment) and claim that it is valid. (193–194.)

Some earlier circuit court cases, opposed to the *Snyder* case, *supra,* are commented on in *Kinsett* v. *Stephens,* 18 Blatchf. 397, by Judge Blatchford, who later delivered the opinion in the *Snyder* case.

It is now settled that a tax can not be enjoined because of its unconstitutionality. *Shelton* v. *Platt,* 139 U. S. 591; *Allen* v. *Pullman's Palace Car*

Co., 139 U. S. 658. The only class of cases falling outside of the statute (3224 R. S.) are those wherein there is no color of authority for the assessment, and even then additional equities must intervene. In these present cases the taxes have been assessed confessedly under color of law, for the main argument is that the law *requiring the assessment* is unconstitutional.

Notwithstanding a general assertion of the sort, no facts are alleged indicating any greater danger of multiplicity of suits, or clouds on titles, in connection with the enforcement of these taxes, than in the case of any other tax. *Dows* v. *Chicago*, 11 Wall. 108; *Southern Railway Co.* v. *King*, 217 U. S. 524, 534, 536. That thousands of different taxpayers would be forced to sue, each for his own tax, does not constitute "multiplicity." One individual or a set of individuals must be compelled to institute many suits to establish a single or common right before "multiplicity" can arise.

These principles govern not only the Dodge cases, but the Brushaber and Stanton cases as well. "The purpose" of these two latter suits is to restrain the collection of the income tax, else they necessarily present but moot questions not reviewable by courts. To be effective the relief must protect the corporation against any liability to pay the tax. Either the injunction would be a good defense to the corporation against attempts of the collector to enforce the tax, or it would be a mere *brutum fulmen*.

On account of the peculiar circumstances there obtaining, the assumption of jurisdiction in the *Pollock* case (157 U. S. 429) can not be taken as authority. In *Straus* v. *Abrast Realty Co.*, 200 Fed. 327, Judge Veeder held that these statutes prevent a suit by a stockholder against a corporation to restrain the latter from paying a Federal tax; and speaking of the *Pollock* case in *Corbus* v. *Gold Mining Co.*, 187 U. S. 455, 459, this court said:

> But that case does not determine to what extent a court of equity will permit a stockholder to maintain a suit nominally against the corporation but really for its benefit.

And on pages 461–463 this court applied the principle laid down in *Hawes* v. *Oakland*, 104 U. S. 450, to a bill to restrain a corporation from paying a tax, thereby confining the jurisdiction to cases where the directors are clearly acting *ultra vires*, or where they, or a majority of the stockholders, are threatening action in their own interest to the detriment of the corporation, all of which must appear by averment of specific facts rather than by general allegation. *Southern Railway Co.* v. *King, supra.* These bills do not negative the possibility that the directors are acting in good faith for what they believe to be the best interest of the corporation, and the mere threatened payment of a tax which some stockholder claims to be unconstitutional is not an *ultra vires* act.

The supplemental bill in No. 213 (Dodge-Brady case) even with the aid of Equity Rule 22 can not give the court belated jurisdiction, (a) because the cause was never transferred to the law side of the court as required by the rule, and without transfer no jury trial could have been had on any issue that might afterwards have been joined upon any of the matter averred in paragraphs VIII and XI and the first sentence of XII of the bill; (b) the prayer for equitable relief was still continued; and (c) at the time of the filing of the supplemental bill there had been no decision by the Commissioner on the appeal taken by Dodge Brothers.

Assignment No. 1 (p. 5, additional brief, Dodge-Brady case, No. 213), complaining of a dismissal without reservation, may not be considered, because (1) it goes not to the legal propriety, but only to the *form* of dismissal, and no such error was assigned in connection with the appeal when taken (R., 43); and (2) appellants did not, in the court below, either object to the form or apply to that court to change the form of the decree.

The Government is insistent upon its contention of lack of jurisdiction as to the cases affected thereby, because it deems it important that complaining taxpayers be, in the future, confined to proper procedure, to the end that the confusion and embarrassment otherwise resulting to the revenue may hereafter be avoided.

THE MERITS.

I.

LACK OF UNIFORMITY CAN NOT BE SUCCESSFULLY URGED.

1. Income taxes. at least when laid on income derived from real or personal property, are direct taxes, and therefore not subject to the uniformity rule, EXPRESSLY prescribed by the Constitution.

(*a*) It is settled that the uniformity requirement of clause 1 of section 8 of Article I of the Constitution, is limited to duties, imposts, and excises, and does not apply to *direct* taxes. *Pollock* v. *F. L. & T. Co.*, 157 U. S., 557; *Spreckels Sugar Refining Co.*, v. *McLean*, 192 U. S. 397, 413; *License Tax Cases*, 5 Wall. 462, 471. And the *Pollock* case (158 U. S. 601, 637), finally determines that a tax on income derived from either real or personal property is a *direct* tax. In none of the cases at bar does the record affirmatively show that there is involved any tax on income derived from any other source; for in the *Dodge* cases, the return was on invested capital, whether the partnership income be regarded as from the plant (realty)or from the manufacture and sale of automobiles (personalty). Therefore, no question as to any other kind of income tax is now before this court. *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 177; *Southern Ry.* v. *King*, 217 U. S. 534; and *Hatch* v. *Reardon*, 204 U. S. 160 and cases.

(*b*) Apportionment being restricted to *direct* taxes *only* (*Flint* v. *Stone Tracy Co.*, *supra* 152), the Sixteenth Amendment, in removing that restric-

tion, recognized *any* tax upon income " from whatever source derived " as a *direct* tax, and as such subject to the apportionment rule unless specially exempted.

In appellant's brief in the Dodge-Osborn case (No. 396), it is said:

> That decision (Pollock case) was authoritative and final. The Sixteenth Amendment recognizes it as a permanent interpretation of the Constitution. (9.)

(*c*) In their briefs in all these cases appellants admit that the taxes here involved are *direct*. Brushaber brief, pages 14, 16, 66–69; Dodge-Brady brief (Baker), pages 20, 22; (Guthrie), pages 6, 10–12 (quoting and distinguishing the *Flint* case); Dodge-Osborn brief, page 9; Stanton brief, pages 3, 4, 36, 59, 74, 96, 114, 130, 136, 140; Thorne brief, pages 19, 38, 45, 47.

2. The Constitution imposes on the taxing power no rule of IMPLIED or inherent uniformity.

If uniformity was an essential of every *tax*, then the provision that " all duties, etc., shall be uniform throughout the United States " might as well have been omitted from the Constitution. This court, however, has repeatedly said that this express limitation, as well as that of *apportionment*, found in clause 4 of section 9 of Art. III and clause 3 of section 2 of Art. I, is vital. In the *Pollock* case, *supra* (157 U. S. 557), this court quotes from the opinion of Mr. Chief Justice Chase

in the *License Tax Cases,* 5 Wall. 462, 471, as follows:

> It is true that the power of Congress to tax is a very extensive power. It is given in the Constitution, with only one exception and *only two qualifications.* Congress can not tax exports, and *it must impose direct taxes by the rule of apportionment, and indirect taxes by the rule of uniformity. Thus limited, and thus only, it reaches every subject, and may be exercised at discretion.*

What language could more clearly express the idea that the power is unlimited save by these two qualifications? Referring to excises in *Patton* v. *Brady,* 184 U. S. 608, this court said:

> The exercise of the power is therefore limited by the rule of uniformity. The framers of the Constitution, the people who adopted it, *thought that limitation sufficient, and courts may not add thereto.* (622.)

See also *McCray* v. *United States,* 195 U. S. 27; *Flint* v. *Stone Tracy Company, supra.*

If they may not add to the express limitation of uniformity in clause 1, *supra,* how may they add to the express limitation of apportionment in clause 4, *supra,* an additional *implied* requirement of uniformity; and why was the requirement of uniformity expressly inserted in the former clause, and entirely omitted from the latter?

Appellants in the Thorne brief (p. 39) quote Mr. Cooley as follows:

> And as all are alike protected, so all alike should bear the burden.

In the text the sentence reads:

> And as all are alike protected, so all alike should bear the burden, *in proportion to the interest involved.*

The underscored words dispense with absolute equality, and preserve the right of selection of subjects and classes of persons to be taxed. As uttered by the author, the rule is correctly stated; as excised by appellant, it is not.

Equality of taxation as between individuals can not be developed from either the "equal protection" or the "due process" clauses of the Fourteenth Amendment, because that amendment has no application to the Federal Government; nor from the Fifth Amendment, because that amendment in nowise limits the taxing power of Congress. *Billings* v. *United States,* 232 U. S. 261, 282. Moreover, neither of these amendments would demand any such result if they could be applied. This will be elaborated later.

3. The rule of uniformity, where applicable, is not violated by either exemption, classification, or discrimination unless these be so arbitrary and outrageous as to indicate favoritism or prejudice.

Assume for the sake of argument a tax controlled by the uniformity rule. The taxing power and the

war power are the broadest powers of government. Surely, if the former carries the right to destroy, any mere hardship or illogical or unscientific application can not defeat a taxing statute.

In *Knowlton* v. *Moore,* 178 U. S. 41, this court, speaking through the present Chief Justice, said:

> * * * if a lawful tax can be defeated because the power which is manifested by its imposition may when further exercised be destructive, it would follow that every lawful tax would become unlawful, and, therefore, no taxation whatever could be levied. (60.)

In *Flint* v. *Stone-Tracy Co.,* 220 U. S. 107, this court, through Mr. Justice Day, said:

> The argument, at last, comes to this: That because of possible results, a power lawfully exercised may work disastrously, therefore the courts must interfere to prevent its exercise, because of the consequences feared. No such authority has ever been vested in any court. (169.)

The rule against discrimination applicable to antitrust cases, rate-regulation cases, etc., is not the correct measure of the limitation in this regard on the taxing power.

In *Cook* v. *Marshall County,* 196 U. S. 261, this court, speaking of antitrust and rate regulation cases, said:

> These cases, however, have but limited application to laws imposing taxes where the right of classification is held to permit of

> discrimination between different trades and callings *when not obviously exercised in a spirit of prejudice or favoritism.* (Citing cases.) (274.)

Again, speaking of the subject from the standpoint of the taxing power, and in *Nicol* v. *Ames*, 173 U. S. 509, this court said:

> The question always is when a classification is made, whether there is any reasonable ground for it, or whether it is *only* and simply arbitrary, based upon no real distinction and entirely unnatural. (Citing cases.) If the classification be proper and legal, then there is the requisite uniformity in that respect. (521.)

Mindful of these considerations, let us now see how this court has applied each, the *express* limitation of uniformity in clause 1 of section 8 of the Constitution, and the alleged *implied* requirement of uniformity sought to be deduced from the Fifth Amendment; or even through the Fifth, from the Fourteenth Amendment.

A. The express uniformity clause of the Constitution requires only geographical and not intrinsic uniformity.

It is no longer open to debate that the words, "shall be uniform throughout the United States," in clause 1, section 8, Article I of the Constitution require *geographical* uniformity only; and that the latter term means not intrinsic equality operating alike on all persons subject to a tax, but only like

operation on those within the *same class* in *every part* of the United States.

In *Knowlton* v. *Moore, supra,* this court, construing the Legacy Tax of 1893 ,and speaking through the present Chief Justice, states the opposing contentions and the conclusions of the court as follows:

> On the one side the proposition is that the command that duties, imposts, and excises shall be uniform throughout the United States relates to the inherent and intrinsic character of the tax; that it contemplates the operation of the tax upon the property of the individual taxpayer and exacts that when an impost, duty, or excise is levied it shall operate precisely in the same manner upon all individuals; that is to say, * * * shall be equal and uniform in their operation upon persons and property in the sense of the meaning of the words "equal and uniform," as now found in the constitutions of most of the States of the Union. The contrary construction is this: That the words "uniform throughout the United States" do not relate to the inherent character of the tax as respects its operation on individuals, but simply requires that whatever plan or method Congress adopts for laying the tax in question, the same plan and the same method must be made operative throughout the United States; that is to say, that wherever a subject is taxed anywhere the same must be taxed everywhere throughout the United States, and at the same rate. (84.)
> * * *

> By the result, then, of an analysis of the history of the adoption of the Constitution it becomes plain that the words "uniform throughout the United States" do not signify an intrinsic, but simply a geographical uniformity. (106.)

In *Billings* v. *United States,* 232 U. S. 261, this court, through the present Chief Justice, said:

> It has been *conclusively* determined that the requirement of uniformity which the Constitution imposes upon Congress in the levy of excise taxes is not an intrinsic uniformity, but merely a geographical one. (Citing the *Flint, McCrea,* and *Knowlton* cases.) (282.)

B. Assuming also that the Fifth Amendment controls the taxing power—as it does not—and even that the "equal protection" requirement of the Fourteenth Amendment may be either read into or spelled out of the language of the Fifth Amendment—as it may not—neither would operate to forbid reasonable exemption, classification, or discrimination.

This court has twice, for argument's sake merely, assumed that which appellants apparently take as the basis of the major part of their argument, i. e., that the "equal protection" clause is to be treated as a part of the Fifth Amendment. Thus considering the subject, it has decided (1) that the limitation imposed on Congress by the Fifth Amendment at most can not be greater than that imposed on the States by the Fourteenth Amendment, and therefore if the Fourteenth Amendment does not operate to deprive the States of the power to exempt or classify, no more can the Fifth Amendment so operate as against the General Government.

In *District of Columbia* v. *Brooke*, 214 U. S. 138, this court, through Mr. Justice McKenna, said:

> However, the question of the power of Congress, broadly considered, to discriminate in its legislation is not necessary to decide, for whether such power is expressly or impliedly prohibited, the prohibition can not be stricter or more extensive than the Fourteenth Amendment is upon the States. That Amendment is unqualified in its declaration that a State shall not "deny to any person within its jurisdiction the equal protection of the laws." Passing on that Amendment, we have repeatedly decided—so often that a citation of the cases is unnecessary—that it does not take from the States the power of classification. And also that such classification need not be either logically appropriate or scientifically accurate. The problems which are met in the government of human beings are different from those involved in the examination of the objects of the physical world and assigning them to their proper associates. A wide range of discretion, therefore, is necessary in legislation to make it practical, and we have often said that the courts can not be made a refuge from ill-advised, unjust, or oppressive laws. (150.)

And again in the *Second Employers' Liability cases*, 223 U. S. 1, this court, through Mr. Justice Van Devanter, said:

> But it does not follow that this classification is violative of the "due process of law"

> clause of the Fifth Amendment. Even if it be assumed that that clause is equivalent to the " equal protection of the laws " clause of the Fourteenth Amendment, *which is the most that can be claimed for it here,* it does not take from Congress the power to classify, nor does it condemn exertions of that power merely because they occasion some inequalities. On the contrary, it admits of the exercise of a wide discretion in classifying according to general, rather than minute, distinctions, and condemns what is done only when it is without any reasonable basis, and therefore is purely arbitrary. (52, 53.)

That the Fourteenth Amendment does not prevent exemptions or classifications not arbitrary in their nature is no longer an open question. *Barrett* v. *State of Indiana,* 229 U. S. 26, 29; *International Harvester Co.* v. *Missouri,* 234 U. S. 199, 214, 215; *Metropolis Theater Co.* v. *Chicago,* 228 U. S. 61, 69; *Lindsley* v. *National Carbonic Gas Co.,* 220 U. S. 61, 78.

Appellants rely on *Southern Railway Co.* v. *Greene,* 216 U. S. 400, in which case this court refused to sanction a certain legislative classification. Later, in the *Billings* case, *supra,* when, as appears from the reported synopsis of briefs there were pressed upon this court the *Lindsley* and *Barrett* cases, *supra,* on the one hand, and the *Southern Railway Co.* case upon the other—though the latter, like the *Billings* case, involved discrimination in rate as between a domestic and a foreign taxpayer—it up-

held the principle of *Lindsley* and *Barrett* cases, which we claim are controlling here. The State enactment involved in the *Southern Railway Co.* case was held to violate the Fourteenth Amendment; but the Federal power involved in the *Billings* case was held to be unaffected by either the Fourteenth or Fifth Amendments.

As to the power to exempt, this court in *Gibbons* v. *District of Columbia,* 116 U. S. 404, said:

> In the exercise of this power, Congress, like any State legislature unrestricted by constitutional provisions, may at its discretion wholly exempt certain classes of property from taxation or may tax them at a lower rate than other property. (408.)

In *Beers* v. *Glynn,* 211 U. S. 477, this court quoted from its opinion in *Magoun* v. *Illinois Trust & Savings Bank,* 170 U. S. 299, as follows:

> Nor do the exemptions of the statute render its operation unequal within the meaning of the Fourteenth Amendment. The right to make exemptions is involved in the right to select the subject of taxation and apportion the public burdens among them, and must consequently be understood to exist in the lawmaking power wherever it has not in terms been taken away. To some extent it must exist always, for the selection of subjects of taxation is of itself an exemption of what is not selected. Cooley on Taxation, 200; see also the remarks of Mr. Justice Bradley in *Bell's Gap Railroad* v. *Pennsylvania,* 134 U. S. 232. (482.)

See also *Welch* v. *Cook*, 97 U. S. 541; *Home of the Friendless* v. *Rouse*, 8 Wall. 430; *Salt Co.* v. *East Saginaw*, 13 Wall. 373.

Finally, noticing a single additional contention advanced in one of appellants' briefs, in connection with alleged limitations on the Federal power of taxation, we deem it sufficient to say that we feel that nothing would be gained by discussing the distinction attempted to be drawn by counsel in the *Brushaber* brief (pp. 23–25) between so-called "primary powers" of Congress and its "secondary or ancillary powers."

C. Selection and classification is an exclusive function of Congress until its exercise becomes plainly the result of prejudice or favoritism.

The largest latitude is allowed. Nothing short of action so arbitrary as to clearly indicate favoritism or prejudice will justify interference with a taxing statute. Cooley on Constitutional Limitations, third edition, page 739, says:

> The constitutional requirement of equality and uniformity only extends to such objects of taxation as the legislature shall determine to be properly subject to the burden. *The power to determine the persons and the objects to be taxed is trusted exclusively to the legislative department* * * *.

In *Pacific Insurance Co.* v. *Soule*, 7 Wall. 433, this court said:

> Congress may prescribe the basis, fix the rates, and require payment as it may deem

proper. Within the limits of the Constitution it is supreme in its action. No power of supervision or control is lodged in either of the other departments of the Government. (443.)

In *McCray* v. *United States,* 195 U. S. 27, this court, speaking through the present Chief Justice, quoted from *Veazie Bank* v. *Fenno,* 8 Wall. 548, as follows:

> The power to tax may be exercised oppressively upon persons but the responsibility of the legislature is not to the courts but to the people by whom its members are elected. (57.) * * * The right of Congress to tax within its delegated power being unrestrained except as limited by the Constitution, it was within the authority conferred on Congress to select the objects upon which an excise should be laid. (61.)

In *Treat* v. *White,* 181 U. S. 264, this court said:

> The power of Congress in this discretion is unlimited. (269.)

In the *Flint* case, *supra,* this court quoted from *Patton* v. *Brady, supra,* as follows:

> It is no part of the function of a court to inquire into the reasonableness of the excise, either as respects the amount or the property upon which it is imposed. (167.)

In *Lindsley* v. *Natural Carbonic Gas Co.,* 220 U. S. 61, this court, speaking through Mr. Justice Van Devanter, said:

> A classification having some reasonable basis does not offend * * * merely be-

> cause it is not made with mathematical nicety or because in practice it results in some inequality. (78.)

In *Metropolis Theater Co.* v. *Chicago,* 228 U. S. 61, this court, through Mr. Justice McKenna, said:

> To be able to find fault with a law is not to demonstrate its invalidity. It may seem unjust and oppressive, yet be free from judicial interference. The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific. * * * It is only its *palpably arbitrary* exercise which can be declared void under the Fourteenth Amendment; (69.) * * *

In *International Harvester Co.* v. *Missouri,* 234 U. S. 199, this court also, through Mr. Justice McKenna, said:

> * * * it is competent for a legislature to determine upon what differences a distinction may be made for the purpose of statutory classification between objects otherwise having resemblances. Such power, of course, can not be arbitrarily exercised; the distinction must have reasonable basis. (215.)

In *Barrett* v. *State of Indiana,* 229 U. S. 26, this court, through Mr. Justice Day, said:

> The equal protection of the laws requires laws of like application to all similarly situated, but in selecting some classes and leaving out others the legislature, while it keeps

within this principle, is, and may be, allowed wide discretion. * * * The legislature is permitted to make a reasonable classification, and before a court can interfere with the exercise of its judgment it must be able to say that there is no fair reason for the law that would not require with equal force its extension to others whom it leaves untouched. (29, 30.)

In *Nicol* v. *Ames, supra,* this court said:

> The question always is, when a classification is made, whether there is any reasonable ground for it, or whether it is *only* and simply *arbitrary, based upon no real distinction* and *entirely unnatural.* (521.)

4. None of the exemptions or discriminations here complained of produce lack of uniformity.

Before considering each alleged illegal exemption or discrimination, let us recall the burden appellants assume in asking this court to declare this tax act unconstitutional.

In *Nicol* v. *Ames, supra,* this court said:

> It is always an exceedingly grave and delicate duty to decide upon the constitutionality of an act of the Congress of the United States. The presumption, as has frequently been said, is in favor of the validity of the act, and it is only when the question is free from any reasonable doubt that the court should hold an act of the lawmaking power of the Nation to be in violation of that fundamental instrument upon which all the powers

> of the Government rest. This is particularly true of a revenue act of Congress. The provisions of such an act should not be lightly or unadvisedly set aside, although if they be plainly antagonistic to the Constitution it is the duty of the court to so declare. The power to tax is the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to the natural man. It is not only the power to destroy, but it is also the power to keep alive. * * * But while yielding implicit obedience to these constitutional requirements (Constitution, Art. I, sec. 8, and sec. 9, subdivisions 4 and 5) it is no part of the duty of this court to lessen, impede, or obstruct the exercise of the taxing power by merely abstruse and subtle distinctions as to the particular nature of a specified tax, where such distinction rests more upon the differing theories of political economists than upon the practical nature of the tax itself. (514, 515.)

In *Lindsley* v. *Natural Carbonic Gas Co., supra,* this court said:

> One who assails the classification in such a law must carry the burden of showing that it does not rest upon any reasonable basis but is essentially arbitrary. (78, 79.)

With our angle of view thus established, we now apply the test of the rule to the several exemptions and alleged discriminations here complained of.

A. The EXEMPTIONS (of $3,000 of the income of an individual and of the entire income of certain organizations and associations) were within the exempting power.

It is unnecessary to establish argumentatively the power to make either of these exemptions. This court said the final word in *Flint* v. *Stone-Tracy Co., supra,* as follows:

> It is again objected that incomes under $5,000 are exempted from the tax. It is only necessary, in this connection, to refer to *Knowlton* v. *Moore,* 178 U. S., *supra,* in which a tax upon inheritances in excess of $10,000 was sustained. In *Magoun* v. *Illinois Trust & Savings Bank,* 170 U. S. 283, 293, a graded inheritance tax was sustained. As to the objections that certain organizations, labor, agricultural and horticultural, paternal and benevolent societies, loan and building associations, and those for religious, charitable, or educational purposes, are exempted from the operation of the law, we find nothing in them to invalidate the tax. As we have had frequent occasion to say, the decisions of this court from an early date to the present time have emphasized the right of Congress to select the objects of excise taxation, and within this power to tax some and leave others untaxed, must be included the right to make exemptions such as are found in this act. (173.)

It is submitted that in view of the many cases of *property* taxation, of which *Home of the Friendless* v. *Rouse, Salt Co.* v. *East Saginaw,* and *Gibbons* v. *District of Columbia,* all *supra,* are typical

this court can not distinguish between the Corporation-Tax Act of 1909 and the Income-Tax Law of 1913. The power to tax at all (in the instant case given specifically by the Sixteenth Amendment) is the essential element, not the nature or character of the tax.

Moreover, if any distinction is to be made, it is submitted that it must be drawn in favor of the constitutionality of this statute, for if an income tax is to be withdrawn from the class of excises it must be withdrawn also from the operation of the rule of uniformity which applies only to such taxes.

It is significant that in the *Flint* case this court deliberately refused to follow the reasoning upon this question of exemptions of Mr. Justice Field in his concurring opinion in the *Pollock* case upon its first hearing. (157 U. S. 429, 591 et seq.) This opinion, which, while nominally concurring, canvassed a question upon which the court avowedly stood equally divided, is extensively quoted in several of appellants' briefs.

In *Knowlton* v. *Moore, supra,* this court, by the present Chief Justice, said:

> * * * taxes imposed with reference to the ability of the person upon whom the burden is placed to bear the same have been levied from the foundation of the Government. So, also, some authoritative thinkers and a number of economic writers contend that a progressive tax is more just and equal than a proportional one. In the absence

> of constitutional limitation the question whether it is or is not is legislative and not judicial. (109.)

The principle of exempting small incomes finds support in the cases in this court involving inheritance-tax statutes. Although some of the appellants here deny the analogy, this court has expressly recognized it. *Flint* v. *Stone-Tracy Co., supra,* 173.

The Income-Tax Act of New Zealand (1894) exempts $1,500; of Massachusetts (1902) $2,000; of South Carolina, (1912) $2,500; and of Oklahoma (1907) $3500; while the Federal act of 1894 carried an exemption of $4,000. In view of the dates of these different enactments and the utterances of Mr. Justice Harlan (*infra*) as to the then (1894) cost of living, together with the well-known increase in living cost that has taken place in the last 20 years, it can hardly be said that the present exemption of $3,000 is so large as to be unreasonable; much less that it is so arbitrary as to indicate prejudice or favoritism.

In *Peacock* v. *Pratt,* 121 Fed. 772, 777 the Ninth Circuit Court of Appeals considering the $1,000 special exemption in the Hawaiian income act, said:

> It (the power to make reasonable exemptions) has been upheld on grounds of enlightened public policy—a public policy which seeks to exclude from taxation the living expenses of the average family, and thus to enable the poor man to escape becoming a public burden. It rests upon the theory

> that the exemption results in ultimate benefit to the taxpayer, which compensates him for the additional burden of taxation which he is thereby called upon to bear. * * * *If the power to make exemptions be once conceded, the amount of the exemption is largely within the discretion of the legislature—a discretion which is not subject to review in the courts unless it be clearly shown to have been abused.* (777.)

Appellant in the *Thorne* case (p. 66) cites a decision of the Supreme Court of Hawaii, *Campbell* v. *Shaw*, 11 Haw. 112, holding an earlier statute of substantially the same tenor to be unconstitutional. Hawaii is in the Ninth Circuit and the Circuit Court of Appeals is the court of last resort in that circuit. Moreover, the act involved in the case is easily distinguished from that in the case at bar. The former exempted $2,000 upon all incomes up to $4,000 but required the man whose income was $4,001 to pay the tax on the full amount. The Territorial court noted that fact in its opinion when it said:

> But the statute in question does not exempt from taxation all incomes to the amount of $2,000, but imposes upon him who receives over $4,000 a year a tax of 1 per cent upon the whole amount, whereas the person whose income is less than $4,000 pays only on the excess of income over $2,000. It is well settled that the legislature has the power to classify objects of taxation, but it is equally well settled that selections can not

be made out of a class for taxation and others of the same class be exempted. (120, 121.)

Although the question of exemptions was not discussed in the main opinion, the views of Mr. Justice Harlan upon this point in his dissenting opinion in the *Pollock* case (158 U. S.) are illuminating. He says:

> In this connection, and as a ground for annulling the provisions taxing incomes, counsel for the appellant refers to the exemption of incomes that do not exceed $4,000. It is said that such an exemption is too large in amount. That may be conceded. But the court can not for that reason alone declare the exemption to be invalid. Every one, I take it, will concede that Congress, in taxing incomes, may rightfully allow an exemption in some amount. That was done in the income-tax laws of 1861 and in subsequent laws, and was never questioned. Such exemptions rest upon grounds of public policy, of which Congress must judge, and of which the court can not rightfully judge; and that determination can not be interfered with by the judicial branch of the Government, unless the exemption is of such a character and is so unreasonably large as to authorize the court to say that Congress, under the pretense merely of legislating for the general good, has put upon a few persons burdens that, by every principle of justice and under every sound view of taxation, ought to have been placed upon all or upon

the great mass of the people. *If the exemption had been placed at $1,500 or even $2,000, few, I think, would have contended that Congress, in so doing, had exceeded its powers. In view of the increased cost of living at this day, as compared with other times, the difference between either of those amounts and $4,000 is not so great as to justify the courts in striking down all of the income tax provisions.* The basis upon which such exemptions rest is that the general welfare requires that in taxing incomes, such exemption should be made as will fairly *cover the annual expenses of the average family, and thus prevent the members of such families becoming a charge upon the public.* The statute allows corporations, when making returns of their net profits or income, to deduct actual operating and business expenses. Upon like grounds, as I suppose, Congress exempted incomes under $4,000. (675–676.)

NOTE.—This point is asserted in the Brushaber and Stanton complaints, but not urged in the brief in either of these cases. It is discussed, only as to its first phase (the $3,000 exemption), in the Thorne brief, though raised in the complaint and assignments of error only in a general way, if at all.

B. The various alleged DISCRIMINATIONS were within the selecting and classifying power.

The following outline will be observed in discussion:

(1) *Discriminations against corporations, and classes of corporations.*

(*a*) In not allowing corporations $3,000 exemption, as in case of individuals.

(*b*) In requiring corporations but not individuals to pay the normal tax on corporate dividends.

(*c*) In requiring certain corporations to collect "at the source." Discussed in III, *infra.*)

(*d*) In allowing corporations generally to deduct only an arbitrary amount of interest paid on bonded indebtedness, while allowing banks to deduct all interest paid on deposits.

(*e*) In not allowing mining corporations to deduct only a certain portion of their ore depletion.

(2) *Discrimination in surtax provision.*

(*a*) In applying to individuals but not to corporations.

(*b*) In classifying on basis of wealth.

(*c*) In not allowing $3,000 exemption as in case of normal tax.

(*d*) In not allowing deduction of corporate dividends as in case of normal tax.

(*e*) In allowing corporations but not partnerships or individuals, to withhold profits from taxation.

(3) *Discrimination against individuals whose tax is withheld or paid at source.*

(*a*) Loss of use of money and of interest.

(*b*) Double payment in case where source pays but does not "withhold" because of "tax free" covenant. Source pays and individual must also pay and seek refund.

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(*c*) Double loss in case where source withholds but does not pay, individual being obliged to pay and lose twice amount of tax.

(4) *Discrimination against husband and wife living together, only one exemption of $4,000 being allowed in computing the normal tax, and the surtax being levied upon the excess above $20,000 of their aggregate incomes even if neither alone receives $20,000.*

(5) *Discrimination against the house renter in favor of the house owner.*

The argument advanced in the previous part of this division (I) of the brief completely disposes of all of the above alleged discriminations. Each is but an exercise by Congress of its discretion to select the objects of taxation and the details of incidence and operation. Congress having determined that recognized distinctions between individuals and partnerships on the one hand, and corporations on the other, justify separate classification, the courts may not say whether such determination is sound or even expedient. Assuming that Congress has taxed a house renter but failed to place an equal burden on the house owner, this is by no means an outrageous usurpation of power. It is but the exercise of a clearly defined power derived from each the Constitution and the Sixteenth Amendment.

Under protest, we nevertheless further consider severally the discriminations complained of.

(1) Discriminations against corporations and classes of corporations.

Broad fundamental distinctions *for the purposes of taxation* have been drawn between corporations and individuals. Text writers and courts have simply recognized economic conditions that are well understood by everyone.

Black, on Income Taxes, page 28, says:

> The substantial difference between the rights, privileges, duties, and business methods of corporations and those of individuals engaged in business has been thought to afford a reasonable basis for placing them in different classes, for the purposes of taxation. Hence an income-tax law can not be adjudged invalid, as making unjust or illegal discriminations, because it imposes a different rate of taxation upon the income of corporations from that imposed upon the income of individuals, or because it exempts the income of the individuals below a certain sum, but does not grant a similar exemption to corporations. (Citing cases.)

In *Flint* v. *Stone-Tracy Co,.* 220 U. S. 107, 158, this court, in construing the Corporation-Tax Law of 1909, said:

> But, it is insisted, this taxation is so unequal and arbitrary in the fact that it taxes a business when carried on by a corporation and exempts a similar business when carried on by a partnership or private individual as to place it beyond the authority conferred upon Congress. As we have seen,

the only limitation upon the authority conferred is uniformity in laying the tax, and uniformity does not require the equal application of the tax to all persons or corporations who may come within its operation, but is limited to geographical uniformity throughout the United States. This subject was fully discussed and set at rest in *Knowlton* v. *Moore*, 178 U. S. 41, *supra*, and we can add nothing to the discussion contained in that case.

And again at page 161 the court said:

* * * it could not be said, even if the principles of the Fourteenth Amendment were applicable to the present case, that there is no substantial difference between the carrying on of business by the corporations taxed and the same business when conducted by a private firm or individual. The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business without the advantage which inhere in the corporate capacity of those taxed and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock. the advantage of

> business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted which do not exist when the same business is conducted by private individuals or partnerships.

It is true that the court was dealing in the *Flint* case with an excise tax. Nevertheless this quotation is controlling in the present discussion. The charge here is that any distinction between income of individuals and of corporations is without reason, merely arbitrary, and hence illegal. In the *Flint* case this court called attention to substantial differences between business of individuals and of corporations. Those differences existed in 1913 when this act was passed as truly as in 1909, when the Corporation-Tax Act was enacted, or in 1911 when the *Flint* case was decided. Its discretion in having classified a tax upon the basis of those differences is no more the subject of review in 1915 than it was in 1911. The only question is the broad general one, whether there is uniformity *among members of the same class.*

In *Nicol* v. *Ames,* supra, this court construed that provision of the so-called War Revenue Act of 1898, which levied a tax upon sales of property by boards of trade or exchanges. This court said:

> In searching for proper subjects of taxation to raise moneys for the support of the

> Government Congress must have the right to recognize the manner in which the business of the country is actually transacted; how, among other things, the exchange of commodities is effected, what facilities for the conduct of business exist; what is their nature and how they operate; and what, if any practical and recognizable distinction there may be between a transaction which is effected by means of using certain facilities, and one where such facilities are not availed of by the parties to the same kind of a transaction. Having the power to recognize these various facts, it must also follow that Congress is justified, if not compelled, in framing a statute relating to taxation, to legislate with direct reference to the existing conditions of trade and business throughout the whole country and to the manner in which they are carried on. (516.) * * * In our judgment a sale at an exchange does form a proper basis for a classification which excludes all sales made elsewhere from taxation. (521.)

This court has held that even in State taxation, where intrinsic personal uniformity is demanded by the "equal protection" clause, railroad corporations may be classified apart from individuals. *Kentucky Railroad Tax Cases,* 115 U. S. 321, 337, 339. And, further, that express companies may be classed separately from other corporations. *Pacific Express Co.* v. *Seibert,* 142 U. S. 339, 354.

Some of the intrinsic differences are well expressed by the Supreme Court of Wisconsin in *Income Tax Cases*, 148 Wis. 456, as follows:

> Much complaint is made of that part of sec. 1087m–6 which provides a different rate of taxation for the income of corporations from the rate prescribed for individuals, and this also is said to be unjust discrimination. Again the question is whether there be substantial difference of situation between individuals and corporations which suggest and justify this difference in treatment, and again it seems that the answer must be Yes. The corporation is an artificial creation of the State endowed with franchises and privileges of many kinds which the individual has not. * * * The corporate privileges which are exclusively held by corporations, and the real differences between the situation of a corporation and an individual, among which may be mentioned the fact that the corporation never is obliged to pay an inheritance tax, *plainly justify a difference of treatment in the levying of the income tax.*

In Wisconsin the " equal and uniform " clause applies to a tax on property. Viewing the income tax as an excise, the court relieved it of the uniformity test. The case is referred to only as demonstrating the distinctions which make such a classification fair and *reasonable.*

An application of the tests and doctrines formulated in the foregoing cases to the various alleged

discriminations against corporations and classes of corporations completely disposes of each objection; and we ought not, at this late day, to be required to discuss the right to classify corporations apart from individuals for purposes of taxation.

Pursuing a still more minute application of the principles just announced to the specific discriminations charged:

(a) Discrimination in not allowing corporations the $3,000 exemption allowed to individuals.

As matter of course, corporations were not given a $3,000 exemption. That exemption was intended to cover what the late Mr. Justice Harlan referred to in the portion of his dissenting opinion quoted above as "the annual expense of the average family." The corporation has no such annual expense, and it is allowed to deduct such expenses as it has under the heading "ordinary and necessary expenses," which, in turn, are *not* allowed to individuals. While it has an annual business expense, a corporation does not eat, drink, wear clothes, own a dwelling, raise a family, or purchase entertainment, and the special exemption is accorded the individual largely, if not wholly, upon the ground that if any portion of the wherewithal with which he maintains himself and family is taken away he is the more likely to become a public charge, thereby increasing instead of lightening the general tax burden.

NOTE.—This point is asserted in the Brushaber and Stanton complaints, but not discussed in the brief of either of those cases.

(b) Discrimination in requiring corporations and not individuals to pay tax on corporate dividends.

It has been held repeated by this court that the legislature may make a difference, for the purposes of taxation, between the capital stock of a corporation in the hands of the corporation itself and the shares of the same capital stock in the hands of the individual stockholders. *Tennessee* v. *Whitworth,* 117 U. S. 129; *New Orleans* v. *Citizens' Bank,* 167 U. S. 371. In the instant case the distinction between income in the hands of a corporation and of its individual stockholders is entirely analogous.

In the case of *Tennessee* v. *Whitworth, supra,* this court said:

> In corporations four elements of taxable value are sometimes found: 1, franchises; 2, capital stock in the hands of the corporation; 3, corporate property; and, 4, shares of the capital stock in the hands of the individual stockholders. Each of these is, under some circumstances, an appropriate subject of taxation; and *it is no doubt within the power of the State* when not restrained by constitutional limitations, *to assess taxes upon them in a way to subject the corporation or the stockholders to double taxation.* (136, 137.)

In *Powers* v. *Detroit & Grand Haven Ry.,* 201 U. S. 543, this court said:

> That a distinction exists between that which is the property of the several share-

> holders and subject to taxation as other property belonging to them, and that which is the property of the collective incorporated person we call a corporation, and subject to taxation as such, has been repeatedly pointed out. (559, 560.)

Appellant Brushaber seeks, at pages 25–27 of his brief, to show that the act instances "flagrant arbitrariness" in thus embodying what he calls "this legislative disapproval of holding companies." The attack is substantiated neither in reason nor in argument. It is one thing to decry oratorically legislative prejudice against holding companies. It is quite another matter (not attempted, but essential to substantiate his position) to show that holding companies do not present in and of themselves a basis for classification quite distinct from persons doing business in their individual capacity. In *Flint* v. *Stone-Tracy Co., supra,* distinguishing between individuals and corporations, this court said (p. 150) that "the difference * * * is not merely nominal" and held that legislative classifications setting the two apart are entirely reasonable and valid. Surely even greater differences exist between individuals and *holding companies.*

NOTE.—This point is asserted in the complaints and urged in the briefs of both the Brushaber and Stanton cases.

(c) In requiring certain corporations to collect "at the source."

Because this charge of discrimination (as between corporations thus burdened because of having a bonded indebtedness, and those not subject to

the provision for source collection) also involves an independent allegation of unconstitutionality as violating "due process" it will be discussed *in toto* under III, *infra.*

NOTE.—This point is asserted in the complaint and argued in the brief of the Brushaber case and no other.

(d) Discrimination in allowing corporations generally to deduct only an arbitrary amount of interest paid on bonded indebtedness, while allowing banks to deduct all interest paid on deposits.

The charge here is twofold: (1) Discrimination in favor of a corporation having a relatively small indebtedness and (2) in favor of banking, loan, and trust companies in respect to the provisions allowing the deduction of interest payments.

In the *Flint* case, *supra,* this court in expressly passing upon this question, said:

> Again it is urged that Congress exceeded its power in permitting a deduction to be made of interest payments only in case of interest paid by banks and trust companies on deposits, and interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid up capital stock of the corporation or company. This provision may have been inserted with a view to prevent corporations from issuing a large amount of bonds in excess of the paid-up capital stock, and thereby distributing profits so as to avoid the tax. *In any event we see no reason why this method of ascertaining the deductions allowed should invali-*

date the act. Such details are not wholly arbitrary and were deemed essential to practical operation. *Courts can not substitute their judgment for that of the legislature. In such matters a wide range of discretion is allowed.*

It is significant that the provisions of the Corporation-Tax Act of 1909 as to deduction of interest payments, both in the case of indebted corporations and of banks and trust companies, which were being construed by this court in the passage quoted, were in all material respects similar to the corresponding provisions of the Income Tax Act, to which exception is taken in these objections. Also it is to be remembered that in the *Flint* case, *supra,* before justifying the interest deductions of the act of 1909, this court had specifically found that the act applied to realty companies (pp. 169–171). In the instant case it is in connection with a realty company, i. e., in the *Tyee* case, No. 393, that the point of discrimination on account of interest deductions is most strongly urged.

NOTE.—This point is asserted in the Tyee and Brushaber complaints and urged in both briefs.

(e) Discrimination in allowing mining corporations to deduct only a certain portion of their ore depletion.

The special distinction here claimed rests on two grounds—(a) that in allowing mining, but not other corporations, a maximum deduction of 5 per cent "for depletion of ores and all other natural deposits" a tax is laid on *capital;* that this is not

justified by the Sixteenth Amendment and being a direct tax it must be apportioned; and (b), that a classification of mining corporations as against others, is purely arbitrary and rests upon no substantial distinction.

Appellant is apparently confused as to what the act provides. He asserts that all other corporations are entitled to deduct all losses, including all depletion of capital; while mining companies are permitted to deduct a small portion only of such depletion. The act, however, provides that "such corporations" (i. e., all corporations, *including mining,* that are liable to the tax) may deduct from their *gross* income

> all losses sustained within the year * * * including a reasonable allowance for depreciation by use, wear and tear of property, if any; *and,* in the case of mines, a reasonable allowance for depletion of ores and all other natural deposits, not to exceed, etc.

Mining companies therefore, as much as other corporations, are entitled to deduct all losses and a certain class of depreciation. *In addition,* they are permitted to deduct for depletion of capital, a privilege not extended to other corporations. Their complaint must be that to allow them only what is allowed to ordinary corporations is unjust, since their capital is embarked in a wasting business. Doubtless this was the controlling reason why Congress granted them a special 5 per cent additional.

It is difficult to see how they can have any standing in court as special objectors. *Flint* v. *Stone Tracy Co., supra* (177); *Southern Ry. Co.* v. *King,* 217 U. S. 534; *Hatch* v. *Reardon,* 204 U. S. 160.

The argument that the allowance of but a per cent of the depletion makes it a tax upon capital rests upon the fallacious theory that the Amendment operated to deprive Congress of the power to tax *gross* or any other than net income. Such a reading gives the Amendment a restrictive operation, for it will be conceded that if made uniform and properly apportioned Congress could have laid a tax upon gross income before the Amendment had it desired so to do, just as, under the form of an excise, it may lay a tax on gross receipts. The object of the Amendment, as the legislative history demonstrates, was to do away with the need for apportionment declared by the *Pollock* case, Cong. Rec., 60th Cong., 1st sess., vol. 44, pt. 4, pp. 4067, 4068, 4105–4121, 4364, 4390–4441, 4629; pt. 5, pp. App., 117, 119–121, 126, 127, 131, 132. Otherwise, it left the subject untouched. It had no purpose to narrow the power of Congress. On the contrary, it used the general word "income," and added *"from whatever source derived."* It was intended to grant the power to lay a tax without apportionment, not only on the particular kind of income, subject to the decision in the Pollock case and any other kind sought to be reached by the Act of 1894; but also any other kind of income, including all so

treated in the previous legislative action of either England or America. The old legislative phrase was "gains, profits, and income," and the latter word reached beyond either of the former, as it would not if it meant merely *net* income. If "income" meant *only* "net income," then the words "gross" and "net" would be idle terms.

While this act levies a tax on net income only, it is what may be called "statutory net income," in defining which Congress must be governed by practical considerations rather than economic definitions or theories. Thus in this act, inter alia, an individual may not deduct living expense, nor amounts paid for new buildings or permanent improvements; corporations may deduct but a portion of their interest paid; and insurance corporations are allowed peculiar deductions. The resultant statutory net income is a mere declaration by Congress of the amounts that may be deducted from gross income. This declaration is binding on the courts, unless it in some way offends against some of the express provisions of the Constitution relating to taxation.

Unless receipts from ores mined are not gross income the tax can not be objected to, even though mines be not entitled to deduct from gross income *all* their depletion of capital.

That the proceeds of ore mined and sold constitute gross income or gains from business operation has been settled by the case of *Stratton's Independence, Limited,* v. *Howbert,* 231 U. S. 399.

The second question certified to this court in that case was:

> 2. Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned act of Congress?

This court, speaking through Mr. Justice Pitney, answered this question affirmatively, and said:

> The sale outright of a mining property might be fairly described as a mere conversion of the capital from land into money. But when a company is digging pits, sinking shafts, tunneling, drifting, stoping, drilling, blasting, and hoisting ores it is employing capital and labor in transmuting a part of the realty into personalty, and putting it into marketable form. The very process of mining is, in a sense, equivalent in its results to a manufacturing process. And however the operation shall be described, the transaction is indubitably "business" within the fair meaning of the act of 1909; and the gains derived from it are properly and strictly the income from that business, for "income" may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor. (414–415.)

The foregoing language applies with full force to like mining operations when viewed from the standpoint of the present act. True, it is said (p. 416) that it was not necessary for the purposes of the Corporation Tax Act that it should be such

income as would have been taxable as such. The court was referring to a tax on income as such in contradistinction to an excise and to the taxing power as it existed before the passage of the Sixteenth Amendment. At that time apportionment, under the *Pollock* decision, was necessary as to certain kinds of income, and as there was no apportionment provided in the Corporation Tax Act the court was disposing of that feature. It was dealing with the old power, and merely applied the well-settled rule that property itself not subject to taxation may be included in the standard of measure declared for an excise.

We now have a new statute, by its terms reaching all income "from whatever source derived" and all gains and profits from any kind of business whatever, and supported on a proper constitutional basis; and in determining whether the mining operation is "business" and the proceeds gained from ores are "gains from business" or "income" within the definition of the new act we must apply the very test, and determine the question upon the same considerations, that moved this court to that conclusion in the *Stratton* case.

It is true that, perhaps illogically, an *individual* sale of property by its owner or the *mere receipt* of a *debt* in installments is under certain statutes treated as being a conversion of capital from one form into another, and as consequently creating no income. *Foley* v. *Fletcher*, 3 H. & N. 769; *Secre-*

tary of State v. *Scoble,* 1903, A. C. 299; *Stevens* v. *Hudson's Bay Co.,* 101 L. T. Rep. 96; *Commonwealth* v. *Central Transportation Co.,* 145 Pa. St. 89, cited by counsel for appellant, and, perhaps, *Gray* v. *Darlington,* 15 Wall. 63, are illustrative. There is a reason for this holding, for such sporadic payments of large amounts will probably be reinvested, and pay an income tax in their new form. But such cases, it is agreed, have no application where the sales are made as part of a regular business, such as mining ore, etc. Farwell, L. J., in *Stevens* v. *Hudson's Bay Co., supra,* says:

> " * * * It is clear, therefore, that a man who sells his land or pictures or jewels is not chargeable with income tax on the purchase money or on the difference between the amount that he gave and the amount that he received for them. But if, instead of dealing with his property as owner, he embarks on a trade in which he uses that property for the purposes of his trade, then he becomes liable to pay not on the excess of sale prices over purchase prices, but on the annual profits or gains arising from such trade, in ascertaining which those prices will no doubt come into consideration. * * * "

And in *Gray* v. *Darlington, supra,* Mr. Justice Field distinguishes between a person who invests in bonds and later sells them at a profit and a person who engages in the business of buying and selling bonds, in which latter case the total receipts would have to be brought into income.

If the sales of the ore in the regular course of business are treated as *mere* conversions of capital, the State may lose its tax entirely; so also if a deduction be permitted of depletion of capital, since this may almost always be figured so as to equal the net income. Consequently the English courts have held under their acts that mining companies are not entitled to deduct anything for depletion of capital, *Coltness Iron Co.* v. *Black,* 6 App. Cas. 315; *Alianza C.* v. *Bell,* 1904, 2 K. B. 666; 1905, 1 K. B. 184; 1906, A. C. 18. It is claimed that these decisions turn on the peculiar language of the English acts. To this we do not assent, but assuming it to be true, nevertheless it appears from these authorities that both Parliament and the courts thought mines a peculiar form of investment, since they refused to allow them deductions which they allowed to other businesses. In the administration of the Civil War Income-Tax Act the Commissioner of Internal Revenue ruled that " no deduction can be made because of the diminished value, actual or supposed, of the coal vein or bed by the process of mining " (Boutwell on the Direct and Excise Tax System of the United States, pp. 273, 274); and apparently the ruling was never questioned. The same ruling was made in Pennsylvania under its income-tax act, *Commonwealth* v. *The Ocean Oil Co.,* 59 Pa. St. 61; *Commonwealth* v. *Penn. Gas Coal Co.,* 62 Pa. St. 241.

As to discrimination. If the separate classification of mining corporations as to deductions be

based upon any reasonable ground relating to revenue, this court will go no further. To demonstrate such ground, it is only necessary to elaborate the general argument already made. Mining companies have intentionally embarked their capital in an enterprise whose very end is to destroy that capital as a regular business, convert it annually into income, and distribute it as such. "It is capital converted by the deliberate act of its owner into income for the very purpose of being expended annually." No other business is exactly like this in the destruction, without replacement, of capital, and the distribution of it as profits. But, as said by this court in the *Stratton's Independence, Limited,* case, *supra,* p. 415:

> As to the alleged inequality of operation between mining corporations and others, it is of course true that the revenues derived from the working of mines result to some extent in the exhaustion of the capital. But the same is true of the earnings of the human brain and hand when unaided by capital, yet such earnings are commonly dealt with in legislation as income. So it may be said of many manufacturing corporations that are clearly subject to the act of 1909, especially of those that have to do with the production of patented articles; although it may be foretold from the beginning that the manufacture will be profitable only for a limited time, at the end of which the capital value of the plant must be subject to material depletion,

the annual gains of such corporations are certainly to be taken as income for the purpose of measuring the amount of the tax.

In the *Stratton* case, and in other cases tried in the lower courts it appeared that several different theories were entertained by mining experts as to the proper deduction to be allowed mining companies under the Corporation Tax Act. Some based it on the cost of the mine, others on the value per ton of the ore in place figured by different methods. Congress has wisely removed that uncertainty. Appellant Stanton presents an elaborate and difficult calculation (pp. 10 and 11 his brief) by aid of which he reaches the conclusion that one-half the company's net receipts after deducting operating expenses, losses, and depreciation from wear and tear, represents depletion of capital. Without pausing to analyze these figures, it is enough to say that they are " upon the basis of latent and occult intrinsic values," and not " upon considerations that affect market value and have their influence upon men of affairs charged with the management of the business and accounting of corporations that are organized for profit and are engaged in business for purposes of profit," (*Stratton's Independence, Limited,* p. 421.)

Such a plan might be appropriately urged upon Congress. But he may not in this court, substitute his own discretion for the right of selection belonging to Congress. This method is quite as arbitrary as that chosen by Congress.

Moreover, it would clearly be inapplicable to companies extracting stratified minerals, such as coal, clay or limestone, whose extent can be determined with substantial accuracy, and which are bought and sold in place in units of area, or percolating minerals, such as oil and gas, whose extent and quantity are incapable of ascertainment. To sustain the contention of the appellants would therefore be to multiply classifications, and not to diminish them.

Some method must be chosen. The power of choice lay with Congress—not with counsel or the court. It is clear that the *value* of the ore in place can not furnish a correct criterion as to the amount of the deduction. Theoretically what should be set off against " gross income " to produce " net " is " outgo;" that is, the disservices—as opposed to the services—which the capital has caused its owner. This " outgo " is not the value of the capital at the time the deduction is claimed, but its cost. Thus a merchant deducts from his yearly receipts the cost of his article, not its value. It is to be hoped that its value equals what he sells it for, and hence the value test would leave no net income for taxation. And this clearly appears when the merchant buys his goods in one year and sells them in the next. There he is charged with the total receipts as gross income, and is not permitted to deduct the cost, since it was not incurred during the taxing year. (See per Field, J., in *Gray* v. *Darlington,* 15 Wall. 63, 66.) It is clear, therefore, that, however correct

counsel's figures may be, they are based upon an entirely wrong principle.

These were the economic conditions relative to mining companies which Congress faced when this act was passed. Applying the legal principles controlling the power of classification and selection as heretofore developed in this brief, the conclusion follows that such distinctions as are here complained of are free from objection. See also *Ohio Tax Cases,* 232 U. S. 576, 590, 591, and *Southwestern Oil Company* v. *Texas,* 217 U. S. 114, 126, 127.

In the assignment of errors in the Stanton Record, complaint is made that the Act is void because retroactive, not, as charged in the other cases, because it taxed income received during the period between the ratification of the Sixteenth Amendment and the passage of the Act, but because of Section 4, Paragraph S of the law, which made all corporations subject, for the two months of 1913 *prior to the Amendment,* to the provisions of the superseded Corporation Tax Law of 1909. The point is not argued in the Stanton brief, probably because appellant had in the meantime seen the futility of the claim. For January and February of 1913 the tax imposed was avowedly an excise, and the measure of that excise could have been receipts for *any period,* whether past or future. It is asserted that the Act continued the old excise law *as to corporations other than mining companies without change,* whereas in the case of mining companies a new provision was inserted as to deduction

for ore depletion. This assertion is erroneous. The old act was not *continued*. A *new act* was passed, and, as to the two months preceding the Amendment, the tax imposed was professedly an excise. That in some features the *new* was the same as, and in other features different from, the *old* excise makes no difference. What we have said *supra* as to the basis for the distinctions made in the act as to the *income* tax applies equally, if not *a fortiori*, to the *excise*.

NOTE.—Point "e" is discussed in #359 (Stanton case).

(2) Discrimination in surtax provision.

(a) Discrimination in applying to individuals, but not to corporations.

Corporations pay the normal tax on *all* profits, and so these profits are not burdened with a second normal tax when received by stockholders in the form of dividends. *Per contra,* the stockholder pays the surtax on dividends received; and so the corporation does not pay a surtax on the profits from which they are derived. Thus the corporate gain, viewed as a fund, ultimately pays each the normal and the surtax only once. If the corporation paid the surtax the individual would not, as is now the case with the normal tax. The charge of double taxation is thus avoided—Congress having merely elected to affix to the corporate gain the *normal* tax while it was still in the hands of the corporation, and the surtax after it reached the individual stockholder.

NOTE.—This point is asserted in the complaints of the Stanton and Dodge cases, but urged only in the Dodge brief.

(b) Discrimination in classifying upon basis of wealth.

The ordinary system of indirect taxation *upon consumption* places upon the poor person a disproportionate share of the burden of governmental support. Income taxation tends to shift the burden upward. It is undeniable that the greater the income the greater the ease with which the payment of taxes is met. Even allowing for the normal inevitable increase in the "scale of living," he who has the larger income can the more easily shoulder the burden of increasing, as the amount of income increases, not merely the total tax, but also the rate of taxation. At least, Congress has in its discretion determined that the heavier burden can be carried more easily by the larger income and it is not for the courts to say that such classification is outrageous. What has been said *supra*, in relation to the $3,000 specific exemption, and especially in connection with graded inheritance taxes, disposes of the present contention.

This question must be regarded as settled by the *Magoun* case, *supra*, at pages 292, 293, and 296, and by the *Knowlton* case, *supra*, at page 109, if the graduated inheritance tax analogy is applicable, as it was held to be in the *Flint* case, *supra*.

NOTE.—This point is asserted in the Brushaber and Thorne complaints, but urged only in the Thorne brief.

(c) Discrimination in not allowing $3,000 exemption as in case of normal tax.

If, when properly read, the act produces this result, nevertheless the objection is not substantial.

As well argue that the $3,000 exemption should be allowed upon every $5,000 or $10,000 section of an individual's taxable property; that the taxpayer's annual expense allowance should be deducted over and over again upon each taxable division, however arbitrary, of his property. The tax is in reality nothing more than a continuation of the normal tax. It is a tax upon income in excess of $20,000. What may be called the starting point of income taxation, i. e., $3,000, has already been passed within the confines of the $20,000, which is exempted entirely from surtaxation. Not only is the $3,000 exempted, as in the case of the normal tax, but there is an *additional exemption* of $17,000. As well contend that the *normal* tax is unconstitutional because $20,000 is not taken as the starting point, as in the case of the surtax.

NOTE.—This point is asserted in the Brushaber complaint, but not urged in the brief.

(d) Discrimination in not allowing deduction of corporate dividends, as in case of normal tax.

Why should the surtax allow such a deduction? The corporation pays no surtax. The corporate dividends have not, therefore, responded previously to the surtax. The only reason that corporate dividends were relieved from the *normal* tax in the hands of individuals was that they had already paid the *normal* tax (to which the corporation is subject) in the hands of the corporation. As well argue that *all income* (not simply corporate dividends) having paid a *normal* tax, must be deducted from income to

be taxed additionally—in other words, that there can be no surtaxation.

NOTE.—This point is asserted in the Brushaber complaint, but not argued in his brief, probably because Brushaber has not shown that he will ever have to pay a surtax, and surtaxes do not fall upon corporations.

(e) Discrimination in allowing corporations, but not partnerships or individuals, to withhold part of their profits from taxation.

The alleged discrimination arises in connection with the clause of the surtax provision, subdivision 2 of paragraph A of the income-tax section, which reads:

> For the purpose of this additional tax the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits if divided or distributed, whether divided or distributed or not, of all corporations * * *, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided and distributed; and the fact that any such corporation * * * is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax. But the fact that the gains and profits have in any case been permitted to accumulate and become the surplus shall not be construed as evidence of a purpose to escape the said tax

> * * * unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business.

The objection is twofold: (1) On behalf of the individual thus taxed, and (2) on behalf of partnerships and individuals who, it is alleged, suffer discrimination in not being allowed so to withhold profits from taxation.

The first ground of objection, although not involving a charge of discrimination, because it requires only brief treatment, is discussed here, parenthetically.

Appellants in the Baker brief, *supra*, assert that such taxation is "so utterly absurd as to induce levity"; that the stockholder may *never receive* the profits; the surplus may be dissipated and a tax paid upon an alleged income which never materializes. The answer lies in the provisions of the paragraph detailed *supra*. Not *every* undistributed profit is taxed. The provision operates only in case of *fraudulent* evasion. This, alone, would justify the provision.

It is not, however, simply in the light of a penalty that the paragraph is to be justified. A corporation carrying a large surplus, thereby measurably increases its earning power. An undistributed surplus, available for reinvestment and for extension and improvement purposes, constitutes a very real corporate asset. The advantage is by no means

intangible or inconsiderable. To have levied a *surtax* upon stockholders based on all corporate profits, however accumulated or held and even though undivided (which the act has not done), would have worked no hardship. It becomes, at most, another instance of selection and classification and is founded upon real and reasonable distinctions. It may be here noted that the Internal-Revenue Act of July 14, 1870, imposed a tax for the year 1871 of 2½ per cent on all undivided profits of corporations accrued and earned and added to a surplus, contingent, or other fund. This act was construed in *Marquette, Houghton, and Ontonagon Railroad Company* v. *United States*, 123 U. S. 722.

The second objection, *supra*, is groundless. It is discussed in the Baker brief in the *Dodge-Brady* case, No. 213, only.

At page 18 of the Transcript of Record in the *Dodge-Brady* case, No. 213, appears the following:

> Plaintiffs are advised and respectfully submit that permitting corporations to *withhold from taxation* a portion of their gains and profits as a surplus for the needs and purposes of the business in which they are severally engaged and not permitting individuals and partnerships to do so is a discrimination against individuals and partnerships * * * etc.

See also page 12 of the record in the *Dodge-Osborn* case, No. 213, and the Baker brief, *supra*, pages 11, 14, and 15.

The provision in question does *not* accord to corporations any privilege of withholding gains and profits from the surtax, as appears from even a superficial reading thereof.

In the first place, *corporations are not subject* to the *surtax*. Hence this entire provision can have nothing whatever to do with corporations, as such. It deals alone with the surtax, and involves only *individuals*.

In the second place neither this provision nor any other of the act, allows a corporation or an individual to withhold from taxation any portion of its or his *income*. *Income* is taxed and can not escape taxation by being withheld in the hands of anyone, whether corporation, partnership or individual. And, normally, the act taxes nothing except *income*.

This paragraph of the act, however, provides that if an individual either organizes or uses a corporation fraudulently to avoid a *surtax*, to which he alone is liable, by withholding profits from distribution beyond the bona fide needs of the business, he must pay that surtax just as if his fraudulent plan had not been attempted.

Had these earnings been honestly distributed, the individual would have paid a surtax, but no normal tax, thereon. The surtax alone was evaded; and is alone to be imposed as a penalty. Throughout the act the surtax is confined to individuals. (Appellants concede, and otherwise complain of this.) This being so, the exempting clause reliev-

ing the individual stockholders from the surtax on undivided profits honestly withheld must also be confined to individuals.

Corporations and partnerships, like individuals, are taxed upon their entire income, whether distributed or not. It is only as to an individual, however, that the question of taxation of the undivided profits *from his corporate holdings* can ever arise. This provision punishes the fraud by taxing profits not distributed or received, regarding them, because of the fraud, as if constructively received. The penalty operates only against the individual fraudulently using the corporation. It can not operate either on individual or partnerships not related to such a fraud; and therefore the exemption from the penalty, *i. e.*, the privilege of withholding from taxation a reasonable amount of profits, in turn can not operate upon individuals or partnerships not thus fraudulently involved.

By this complaint individuals and partnerships are seeking an exemption from a penalty which never has been, and never can be, enforced against them.

True, section D of the act contains a provision as follows:

> *Provided further,* That any persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether

> divided or otherwise, shall be returned for taxation and the tax paid * * *, etc.

It is argued from the above that partnerships are taxed upon undivided profits. What of it? Corporations, partnerships, and individuals are all taxed upon profits not taken from the undertaking but allowed to remain in the business. The difficulty arises in the distinctions which exist in the respective characters of a partnership and a corporation. The partnership exists only as its individual members exist. The income of a partnership is returned and taxed not as such, but as the income of the individual members thereof. Undivided profits of a partnership are taxed in the hands of the individual partners, just as the undivided profits of a corporation are taxed in the hands of a corporation, and just as profits allowed by an individual to remain in his business are taxed in his hands. But, after taxing undivided profits of a corporation, in the hands of the corporation itself, the act, distinguishing between the corporate entity and that of the individual holder of the corporate stock, has said undivided profits shall, under certain circumstances, bear a *second* burden, to be endured by the stockholder. The distinction was not made between the partnership and the partner, either in the case of actual income or of undivided profits, because the same double entity does not exist. It is in connection only with this concept of double entity in the case of corporations that the

provision in question taxing undivided profits comes into operation.

NOTE.—This point is asserted in the complaint and argued in the brief in the Dodge case and no other.

(3) Discrimination against individuals whose tax is withheld or paid at source.

(a) Loss of use of money and of interest.

It is urged that the individual whose tax is withheld at the source loses the use of the money and interest thereon durnig the period between the withholding and the coming due of the tax. Congress might have made the entire tax payable *upon receipt* of the taxable income. In effect Congress has done this in respect to income from evidences of corporate and fiduciary indebtedness. The reasonableness and justification of the classification thus effected by Congress has been established, *supra*.

NOTE.—This point is asserted in the Brushaber complaint, but is not urged in his brief.

(b) Double payment in case where source pays but does not "withhold" because of "tax-free" covenant. Source pays and individual must also pay and seek refund.

Though raised in the Brushaber complaint, and probably saved in the Assignment of Errors, the point is not argued. This is not surprising. The Treasury Department has never exacted such double tax nor does the act contemplate it. The double taxation could not, in fact, result except through the stupidity or error of the individual taxpayer. Because not argued by appellant, the point is not further considered.

(c) Double loss in case where source withholds but does not pay, individual being obliged to pay and lose twice amount of tax.

This objection can not involve the validity of the act. The taxpayer may or may not be obliged ultimately to bear the burden of a double payment. If he is unable to recover the amount of the tax from his fiduciary agent withholding the amount and failing to pay it to the Government, the loss is owing not to any unconstitutional or invalid provision of the taxing statute, but to an ordinary failure in a contractual relationship. The fact that a servant sent to pay a tax absconds with the currency does not invalidate the taxing law. Nor does it matter that in the instant case Congress has designated the paying agent, while ordinarily the individual chooses his own servant.

NOTE.—This point is asserted in the Brushaber complaint, but not urged in his brief.

A somewhat analogous contention is urged in the Brushaber brief, and is here briefly disposed of. Appellant says that when a corporation pays interest in full upon its obligations without deduction for taxes, pursuant to a usual "tax-free" clause, the corporation must pay the tax upon that interest *even though* the obligee may be entitled to exemption because his income does not exceed $3,000, and the tax in reality not be due. We answer merely that the act, providing completely against the payment of any tax which is not due, indicates specifically all steps to be taken with due diligence toward the claiming of its exemptions. The burden com-

plained of, if endured, results simply from the fact that the obligor on the indebtedness has by contract placed itself in a position where it, instead of the obligee, has an interest to exercise that diligence and claim the exemption. That it does not take the necessary steps in that regard can not affect the rights of the Government to impose its tax.

(4) Discrimination against husband and wife living together, only one exemption of $4,000 being allowed in computing the normal tax, and the surtax being levied upon the excess above $20,000 of their aggregate income, even if neither alone receives $20,000.

The $3,000 exemption was designed to cover living expense. It is undeniable that the legislature in the exercise of its discretion may draw the distinction between the *separate maintenance* of two persons on the one hand and their *combined* maintenance at lesser cost on the other.

To the charge that the surtax is levied upon the excess above $20,000 of the *aggregate* income of husband and wife, even if neither alone receives $20,000, we answer, as in connection with (3), (b), *supra,* that we find no such provision in the act and there is no such practice in its administration. If each alone receives an income of $19,999.99 no surtax is levied upon either.

NOTE.—Point asserted in Brushaber complaint, but apparently abandoned in brief. Thorne brief discusses first phase, i. e., $4,000 limitation, although question does not appear to have been raised in complaint; hence not included in assignment of errors. Neither appellant Brushaber nor appellant Thorne may urge point, since neither has shown himself to be married and living with wife.

(5) Discrimination against the house renter in favor of the house owner.

The legislative power of selection and classification is not violated by such a distinction, if made. The act is as free from objection in this respect as it is in respect to the charge that it discriminates against him who buys his meat and groceries in the market place in favor of the farmer who eats the animal offspring and products raised on his farm. Both charges were incorporated into the bill in the Brushaber case, but appellant has not considered them worthy of discussion in his brief, probably because it is not shown in the record that he is a house-renter nor that he is not a farmer.

II.

THE TAX IS NOT AN INFRACTION OF THE GENERAL POWER OF THE STATES TO AUTHORIZE THE FORMATION OF CORPORATIONS AND JOINT STOCK COMPANIES.

Appellant Brushaber (his brief, pp. 21–23) urges that the taxing power of Congress is impliedly limited by an alleged absolute power of a State to determine forms and methods of property ownership therein, and incidentally to authorize the formation of corporations and determine what burdens shall attach to them and their franchises, and he insists that this tax, so far as it reaches such corporations, wrongfully interferes with such State power.

The counsel who prepared the Brushaber brief advanced a like contention as to interference with

State powers, to this court in his brief filed in the *Flint* case, *supra* (124). In deciding against the contention, this court, in that case, said:

> This proposition is rested upon the implied limitation upon the powers of national and State governments to take action which encroaches upon, or cripples the exercise of the exclusive power of sovereignty in the other. (152) * * * The inquiry in this connection is how far do the implied limitations upon the taxing power of the United States over objects which would otherwise be legitimate subjects of Federal taxation, withdraw them from the reach of the Federal Government in raising revenue because they are pursued under franchises which are the creation of the States. (153) * * * But this limitation has never been extended to the exclusion of the activities of a merely private business from the Federal taxing power, although the power to exercise them is derived from an act of incorporation by one of the States. We therefore reach the conclusion that the mere fact that the business taxed is done in pursuance of authority granted by a State in the creation of private corporations does not exempt it from the exercise of Federal authority to levy excise taxes upon such privileges. (158)

It is submitted that as the question is not one of uniformity, but one of implied general limitation upon the Federal taxing power, no distinction is to be drawn as between an excise and a direct tax, and

that there is no such implied restriction in the case of either.

NOTE.—Although this point is discussed in both the Brushaber and Tyee briefs, it does not appear that it was asserted in the complaint in either of those cases, nor saved by assignment.

III.

THE BURDEN OF "SOURCE COLLECTION" PLACED UPON CERTAIN CORPORATIONS DOES NOT VIOLATE THE CONSTITUTION.

The objection that *indebted corporations* are unjustly burdened with "collection at the source," and other objections growing out of the source-collection feature, are answered by the consideration that there is presumably a very substantial advantage gained by the corporation supported and financed "from the outside," and at least it is true that there is a very *real difference* between a corporation having an interest-paying indebtedness and one which is not thus organized. There is nothing arbitrary or whimsical about a classification based upon such a tangible and fundamental difference in character.

But further justification for placing upon certain corporations, and, indirectly, upon taxpayers holding interest-bearing securities, the burden of "collection at the source," is found in more fundamental considerations.

Benefit to the Government is the first consideration of the framers of a law exercising the power of taxation. Annoyance to the taxpayers and disturbance of business conditions are to be avoided, of

course, wherever possible, but from the very nature of taxation, involving sacrifice by the individual to the State, it is inevitable that sacrifices will result from its enforcement. The great outstanding fact pertinent to the present discussion is that other tax laws which have endeavored to reach incomes without resorting to collection at the source have failed to reach very large portions of profits actually earned which should have been available for revenue purposes. The experience of State governments has shown that about 10 per cent of the taxation upon income from invested money has been collected, where its deduction was not compelled at the time of payment. In *Bank* v. *Commonwealth*, 9 Wall. 353, 363, this court said:

> It is the only mode which certainly and without loss secures the collection of the tax; * * * and * * * the mode which experience has justified * * * as the most convenient and proper, etc.

See also *Home Savings Bank* v. *Des Moines*, 205 U. S. 503. The corporate indebtedness of this country is said to be in excess of $28,000,000,000. The amount of interest paid upon this indebtedness is easily ascertainable. Much of this through sheer inadvertence, some of it perhaps through dishonest motive, would escape taxation without the aid of source collection. Income is even more easily secreted than personal property. If one can easily hide the physical evidences of the principal debt, how much more effectively can one conceal the fact

that income is being received thereon. In Great Britain collection at the source is well established and accomplished by means of a much more complex and onerous procedure than is provided in our act of 1913.

It is urged that while this collection constitutes an expense and burden upon the withholding or collecting agency, it is not a tax which is covered into the Treasury and is therefore not an ultimate benefit to the Government. Such argument is fallacious. Every expenditure of time and effort, whether upon the part of the taxpayer or of the Government collector, produces its benefit to the Treasury not in the actual expenditure in the machinery of payment or collection but in the resulting inflow of revenue. As pointed out above, collection at the source saves to the Government vast amounts of revenue which would otherwise, for one reason or another, never be returned.

This is merely, after all, a question of degree. *Every taxing statute* places upon the taxpayer certain physical burdens in addition to the actual outlay of money. One is required to pay a tax at the office of the Collector of Internal Revenue. He may carry his payment to the office himself, or he may send his messenger. If he sends his messenger shall he be reimbursed for salary and carfare? The individual is required to make certain returns and computations upon blank forms furnished by the Treasury Department. If, instead of doing the

clerical work himself, he employs a secretary must he be compensated for the expenditure? The case is not dissimilar from the burden of "source" collection imposed upon certain corporations. If corporations are to be reimbursed for performing these labors, shall individuals also be compensated? Where shall application of the principle begin and end?

Moreover, after a short period of operation and actual experience the burdens complained of, whether on behalf of the corporate collector or the individual creditor, will be, and have been, considerably minimized. The expense of office assistance, the loss of interest, the inconvenience in negotiability, all these elements and numerous others which the ingenuity of counsel suggest will, through adjustment and regulation, be reduced to practically nothing.

Cooley, on Taxation, at page 832, 3d Ed., says:

> In a few cases, however, in which such a course could not work injustice, the State may reach the party taxed by indirection, and collect in the first instance from someone else, who in turn will become collector from the person on whom the tax is really imposed. The reason for this is, that in such cases it is more convenient to the State, and perhaps makes more certain the collection; and it could be resorted to only when the case is such that injustice could result to no one. A case of the kind is where a tax is imposed on the dividends or other receipts

> of shareholders from the profits of corporations, or upon their shares, or upon the interest paid by indebted corporations, and where the corporation is required to make the payment, which it would then deduct from the payment to be made to shareholders, or to the holders of the evidences of indebtedness. There is no doubt of the right to do this, except as to payments to be made to nonresidents. * * *

(The above deals with *State* taxation.)

And again, at page 34, the same author says:

> The legislature must therefore determine all questions of State necessity, discretion or policy involved, in ordering a tax and in apportioning it *must make all the necessary rules and regulations which are to be observed in order to produce the desired returns, and must decide upon the agencies by means of which collections shall be made.*

The passage last above quoted was cited with approval in *Patton* v. *Brady*, 184 U. S. 608, 620, 621.

In *Bell's Gap Railroad Co.* v. *Pennsylvania*, 134 U. S. 232 at page 239, this court said:

> The corporation, as the debtor of its bondholders, holding money in its hands for their use, namely, the interest to be paid, is merely required to pay to the Commonwealth out of this fund the proper tax due on the security. The tax is on the bondholder, not on the corporation. This plan is adopted as a matter of convenience and as a secure method of collecting the tax. That is all. It injures no

party. It certainly does not infringe the Constitution of the United States by making one party pay the debts and support the just burdens of another party, as is implied in the objection.

In *Cummings* v. *National Bank*, 101 U. S. 153, 156, this court, in holding valid a statute of Ohio which required the officers of the bank to report to the county officers the names and addresses of all stockholders, etc., said:

> In *National Bank* v. *Commonwealth*, 9 Wall. 353, we held that a statute of Kentucky, very much like this, which enabled the State to deal directly with the bank in regard to the tax on its stockholders was valid, and authorized a judgment against the bank which refused to pay the tax. It is true, the statute of Kentucky went further than the Ohio statute, by declaring that the bank *must* pay the tax, while the latter only says it may.

In *National Safe Deposit Co.* v. *Illinois*, 232 U. S. 58, 70, this court said:

> Nor was there any deprivation of property nor any arbitrary imposition of a liability in requiring the company to retain assets sufficient to pay the tax that might be due to the State. There are many instances in which, by statute, the amount of the tax due by one is to be reported and paid by another—as in the case of banks required to pay the tax on the shares of a stockholder. (*National Bank* v. *Commonwealth*, 9 Wall. 353, 363.)

Appellant Brushaber (his brief, p. 49) attempts to avoid the case just cited by the doctrine *de minimis*. Counsel state that an examination of the brief in said case shows that—

> it was not contended that the Illinois inheritance tax placed a financial burden on the safe deposit company nor was such situation passed upon by this court.

In the printed synopses of brief of defendants in error in that case (p. 65 of the Report) appears the following:

> The act does not make the safe deposit company an involuntary tax collector. (Cases cited.) Statutes have frequently required agents to return for taxation property in their possession and made such agents liable for the tax if they surrender the property without the tax thereon being paid. (Cases cited.)

It is submitted that in view of the foregoing and of the unequivocal language of this court in passing upon the points thus raised, this court can not be said to have been applying the doctrine of *de minimis* in the above case.

The underlying principle that a party in possession of property belonging to another may be compelled to pay in the latter's behalf the tax assessed thereon has been too frequently approved to be now disputed. See, in addition to the foregoing authorities, Gray on Limitations of the Taxing Power, sec. 1195 *et seq.*; *Aberdeen Bank* v. *Chehalis County,*

166 U. S. 440, 444; *Merchants' Bank* v. *Pennsylvania*, 167 U. S. 461, 465; *Carstairs* v. *Cochran*, 193 U. S. 10; *Union Bank* v. *City of Richmond*, 94 Va. 316; *Commonwealth* v. *Citizens' National Bank*, 117 Ky. 946.

NOTE.—This point is asserted in the Brushaber complaint and argued in his brief.

IV.

THE TAXATION OF INCOME ACCRUED PRIOR TO THE PASSAGE OF THE ACT VIOLATES NO CONSTITUTIONAL NOR EQUITABLE PRINCIPLE.

So much of the act as seeks to impose the tax upon *income received* and collected prior to the third day of October, 1913, the date of the passage of the act, is claimed to be unconstitutional. It is averred that the act is to that extent void, for the reason that it could not lawfully affect any receipts of the taxpayer accrued before its passage, because such receipts had become property and capital of the taxpayer and had ceased to be income. (Rec., p. 11.)

1. Former income-tax laws have contained the so-called "retroactive" feature.

Income tax laws, both in England and in the United States, have taxed income accrued prior to the date of enactment of the respective statutes. The point of unconstitutionality upon that ground has been raised repeatedly. The previous Federal income tax laws, to wit, the acts of August 5, 1861, 12 Stat. 292; July 1, 1862, 12 Stat. 473, 474; June

30, 1864, 13 Stat. 223, 281, 283; July 4, 1864, 13 Stat. 417; March 2, 1867, 14 Stat. 471, 478, 480; July 14, 1870, 16 Stat. 256; and August 27, 1894, 28 Stat. 553, s. 27, taxed income received prior to the passage of each act during periods respectively as follows: 1861, 7 months and 5 days; 1862 and June, 1864, 6 months; July, 1864, and 1867, 1 year; 1870, 6 months and 14 days; 1894, 7 months and 27 days.

English income-tax laws have provided, in respect to the period of taxation, as follows:

(1) Act of June 22, 1842, 5 and 6 Vict., c. 35, taxed income from April 5, 1842.

(2) Act of June 28, 1853, 16 and 17 Vict., c. 34, taxed income from April 5, 1853.

(3) Since 1861 the English taxing act has been reenacted annually, 16 Halsbury's Laws of England, 609, and has contained similar provisions.

Thus it appears that income tax legislation has from the beginning applied the principle here objected to. Indeed, the English acts have even carried the "*collection at the source*" back into periods and to cover payments antedating the passage of the statutes. Subsection 4 of Finance Act of 1910, *supra;* section 38 of Finance Act of 1894.

The constitutional question now raised could not, of course, arise in England. The parallel is significant only in this. England has maintained for almost a century a system of "income taxation." As a part of its system it has administered so-called

retroactive provisions, and the repeated process of measuring and taxing *receipts prior to the passage of the taxing statute,* has been known as the process of *taxing incomes.* The Sixteenth Amendment provides that Congress may levy and collect "*taxes on incomes,* from whatever source derived," without apportionment. Nothing appears against, and there is everything in favor of, the assumption that the Amendment used the term "*taxes on incomes,*" as the term had been applied and worked out in numberless statutes designating *income taxes* during the past century both in England and in the United States.

2. A period preceding the taxing year is a natural and easy measure of the tax, and whether or not income passes into the realm of capital is not material, for the tax need not attach to any "specific fund" of income, as such.

A nation or a State is confronted with the problem of levying and collecting additional taxes. In fairness, the burden should fall on those able to pay, and income, measured, not by what the taxpayer may receive during the *next succeeding* year, but by what he has received just prior to the taxing date, is the natural factor of determination. There is a present need for revenue. To wait a full calendar year after the passage of the tax law and then to consume a portion of another year in establishing a period for assessment, levy, and collection would not meet that need. The income for the

year preceding becomes the most available measure of the taxpayer's ability to pay.

In this view, it matters not whether income received prior to the passage of the act has become "property." None the less, it may constitute the measure of the tax assessed upon the taxpayer's estate.

The assertion that the act is unconstitutional because it taxes income which had become capital before the passage of the act necessarily involves the concept that taxable income constitutes a *specific fund* out of which the tax is taken, and that if the statute fails to place upon that fund at least a constructive notice of intention to collect the tax, the fund thus escapes the burden, passes into the classification of capital and becomes immune. Appellant Brushaber (brief, p., 72) argues that a power to tax income can be exercised only by taxing it at the moment when it comes in, and that immediately upon its receipt income loses its distinctive character as such and becomes part of the *corpus* and capital of an estate.

Taxable net incomes can not be determined until a balance can be struck at the end of a specific period. Allowable deductions may appear in the taxpayer's account during the last hours of the taxing year, and a gross income, which up to that time had appeared taxable, entirely escape the burden. The tax, when actually ascertained, is assessable against the whole estate of the taxpayer.

There is neither an actual nor a constructive carving of the tax out of any fund identified as income, nor can collection of the tax, once it is assessed, be defeated by any disposition of the income, either by investment, theft, or destruction. It is enough that it was received as income during the period chosen for the laying of the tax.

In *Drexel* v. *Commonwealth*, 46 Pa. St. 31, the Pennsylvania court said (p. 40):

> The English income tax and the United States income tax are based upon the incomes received in preceding years. The present United States income tax is laid upon the income of 1862, and the act of Congress for the 5th of August, 1861, 12 Stat. L. 309, expressly declares that "the tax herein provided shall be assessed upon the annual income of the persons hereinafter named for the year next preceding the 1st of January, 1862." * * *
>
> It is clearly, therefore, perfectly constitutional as well as expedient, in levying a tax upon profits or income, to take as the measure of taxation the profits or income of a preceding year. To tax is legal, and to assume as a standard the transactions immediately prior is certainly not unreasonable, particularly when we find it always adopted in exactly similar cases.

Although applied to statutory conditions somewhat dissimilar to those involved in the Income Tax Law of 1913, the following language of this court in

Stockdale v. *Insurance Companies,* 20 Wall. 323, 331, 332, has an important bearing upon this point:

> The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, can not be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed. * * *

Even in the dissenting opinion in the above case, it is said (p. 341):

> Of course I am not to be understood as maintaining that when the declaratory act was passed Congress had no power to impose a tax upon any income that had been received before that time.

3. That so-called "retroactive" features do not violate the Constitution has been held decisively.

In the *Wisconsin Income Tax Cases,* 148 Wis. 456, the court said:

> One further objection *we overrule here without comment, for the reason that it seems very unsubstantial,* namely, that the law is retrospective and void, because assessed on incomes received during the entire year 1911, while it did not go into effect until July 15th of that year, and also because it includes profits derived from the sale of property purchased at any time within three years previously.

Cooley on Taxation, 3d Ed. pp. 492, 493, and 494, says:

> Unless the constitution prohibits retrospective legislation the basis of an assessment of taxes may as lawfully be retrospective as the reverse; that is to say, it may as well have regard to benefits theretofore received as to those which may be received thereafter. * * * Nor in apportioning the tax between individuals is there any valid objection to making it on consideration of a state of things that may now have come to an end; as where a tax is imposed on the extent of one's business for the preceding year instead of upon an estimate of the business for the year to come. *Drexel* v. *Commonwealth*, 46 Pa. St. 31, * * * One may be taxed upon property which he has long ceased to own when the tax is levied.

Appellant Brushaber (his brief, p. 76) urges that the above case can have no bearing upon the construction of the Sixteenth Amendment, which did not then exist; that the court attached more weight to the general acquiescence in "war taxes" on patriotic grounds than would now be considered proper; and further, that the statute which the court was construing did not impose a new tax *ab initio*, but merely declared the construction of a prior statute. The court said:

> The right of Congress to have imposed this tax by a new statute * * * can not be doubted.

Plainer language could not be found.

See also *Locke* v. *New Orleans*, 4 Wall. 172; *Gray* v. *Darlington*, 15 Wall. 63, 66; *Maine* v. *Grand Trunk Ry. Co.*, 142 U. S. 217; *Patton* v. *Brady*, 184 U. S. 608; *Flint* v. *Stone-Tracy Co.*, 220 U. S. 108.

NOTE.—This point is asserted in the complaints in the Brushaber, Thorne, and Tyee cases, and is argued in the briefs in all of them.

V.

THERE IS NO INVALID DELEGATION OF JUDICIAL AUTHORITY TO THE SECRETARY OF THE TREASURY.

It is said that the act is invalid in delegating to the Secretary of the Treasury power to decide, in certain cases, that the accumulation as surplus of the undistributed profits of a corporation constitutes prima facie evidence of a fraudulent purpose to escape the tax.

The Secretary investigates, reaches a conclusion of fact, and certifies thereto. He simply exercises an administrative function; a judicial power is in no sense involved. Taxing officers are constantly invested with such power and the right to bestow it upon them is set at rest by the following cases: *Murray's Lessees* v. *Hoboken Land Co.*, 18 How. 272; *Fong Yeu Ting* v. *United States*, 149 U. S. 698, 714; *Lem Moon Sing* v. *United States*, 158 U. S. 538, 544; *Nishimura Ekiu* v. *United States*, 142 U. S. 651, 660; *United States* v. *Duell*, 172 U. S. 576, 586; *Butterworth* v. *Hoe*, 112 U. S. 50, 67; *Runkle* v. *United States*, 122 U. S. 543, 557; *United States* v. *Ju Toy*, 198 U. S. 253; *Tang Tun* v. *Edsell*, 223 U. S. 673; *United States* v. *Sing Tuck*, 194

U. S. 161, 170; *Japanese Immigrant Case*, 189 U. S 86, 98; *Turner* v. *Williams*, 194 U. S. 279; *Chin Bak Kan* v. *United States*, 186 U. S. 193; *Fok Yung Yo* v. *United States*, 185 U. S. 296; *Union Bridge Co.* v. *United States*, 204 U. S. 364, 386; *Buttfield* v. *Stranahan*, 192 U. S. 470; *Oceanic Steam Navigation Co.* v. *Stranahan*, 214 U. S. 320.

NOTE.—Point asserted in Brushaber complaint; not argued in brief. Also touched on in Dodge brief, in discussing withholding corporate profits from taxation; but not asserted in complaint nor saved specifically in assignment. Neither Brushaber nor Dodge may raise the question. Neither has shown exercise of alleged "judicial power" in his case, or interest in any fraudulent corporation.

VI.

THERE IS AMPLE PROVISION FOR HEARING AND APPEAL UPON MATTER OF ASSESSSMENT.

It is said that the act is invalid because it permits the Commissioner to make assessments without first giving notice of the intended assessment and opportunity to be heard thereon, *Dodge* v. *Brady*, Record, page 10. Division L of the act (quoted p. 3 this brief) adopted all general statutes providing appeals from tax assessments.

One of these statutes (sec. 3220, R. S.) provides that

> The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized, on appeal to him made, to remit, refund, and pay back all taxes erroneously or illegally assessed or collected.

The claim that the statute does not apply where the assessments are not within the jurisdiction of the officer has been fully answered under the heading "Jurisdiction" of this brief.

Of all the internal revenue statutes, only two have contained provisions for notice and hearing before assessment. (Revised Statutes, section 3309a, relating to deficiency assessments against distillers of fruit brandy, and Revised Statutes, section 3371, providing assessment for omitted returns on tobacco.) Both statutes instance deficiency assessments and establish no rule for the making of regular assessments upon the basis of returns *made by the taxpayers themselves.* No necessity appears for granting notice and hearing before assessment when the return of taxable property emanates from the individual himself and the assessment issues upon that return.

In cases Nos. 213 and 396 the taxpayers made voluntary returns as required by the statute; were notified of the assessments as soon as made thereon; and thereafter filed with the Commissioner an appeal for remission of the surtax.

In *Kentucky Railroad Cases,* 115 U. S. 321, 331, 332, 333, this court said:

> It has, however, been repeatedly decided by this court that the proceedings to raise the public revenue by levy and collecting taxes are not necessarily judicial, and that "due process of law" as applied to that subject does not imply or require the right to

> such notice and hearing as are considered to be essential to the validity of the proceedings and judgments of the judicial tribunals. Notice by statute is generally the only notice given and that has been held sufficient * * * . In its application to proceedings for the levy and collection of taxes it was said in *McMillan* v. *Anderson*, 95 U. S. 37, 42, that it "is not and never has been considered necessary to the validity of a tax" "that the party charged should have been present or had an opportunity to be present in some tribunal *when he was assessed.*" * * * In the proceedings questioned in these cases there was in fact and in law notice and a hearing. The railroad company, by its president or chief officer, is required by law in a specified time to return to the Auditor of Public Accounts, under oath, a statement * * * . This return made by the corporation, through its officers, is the statement of its own case * * * . It is laid by the auditor * * * before the Board of Railroad Commissioners and constitutes the matter on which they are to act * * * .

People's National Bank v. *Marye*, 107 Fed. 570, involved a statute imposing a tax upon bank stock in the hands of individuals and requiring each bank to make a return to the Commissioner, giving the names of stockholders, number of shares held, its market value, etc. The court said:

> A careful inspection of the act shows that the assessor performs no judicial act in what he does, the fair interpretation being that the

> assessment made by him is upon the market value of the stock *as reported to him by the bank, and the act itself fixes the amount of the tax;* and under this view further notice to the taxpayer of the assessment is not required. * * * (580.)

In *Hagar* v. *District,* 111 U. S. 701, 709, it was said:

> Of the different kinds of taxes which the State may impose there is a vast number of which, from their nature, no notice can be given to the taxpayer, nor would notice be of any possible advantage to him. * * * Yet there can be no question that the proceeding is due process of law, as there is no inquiry into the weight of evidence or other element of a judicial nature, and nothing could be changed by hearing the taxpayer. No right of his is therefore invaded.

See also *Pittsburg, etc., R. R.* v. *Board of Public Works,* 172 U. S. 32, 45; *Turpin* v. *Lemon,* 187 U. S. 51, 58; *Glidden* v. *Harrington,* 189 U. S. 255, 258; and *Hodge* v. *Muscatine County,* 196 U. S. 276, 281.

In case the collector is dissatisfied with the taxpayer's return, the act requires him, before *increasing* amounts therein, to notify the taxpayer and afford him an opportunity to be heard; with right of speedy appeal to the Commissioner in the event of increase. (Subdivision d.)

Security Trust Co. v. Lexington, 203 U. S. 323, relied upon in the Dodge-Brady brief, well illus-

trates the distinction, since it involved a statute providing for a special assessment *for back taxes.*

Finally, it is objected that the present law places upon the Commissioner himself the duty of making assessments, thereby neutralizing whatever right of appeal to said official may otherwise have been reserved under the general tax statutes. In answer to this objection it need only be pointed out that by the Revised Statutes said official is *required* to make the assessments under *all internal revenue acts.* (Sec. 3182, R. S.) So that if appellants are correct in their contention all Federal tax laws since 1872, to which sec. 3182, R. S. is applicable, are likewise unconstitutional.

NOTE.—This point is asserted in the complaint in the Dodge case, and urged in their brief.

VII.

THE INVALIDITY OF A PART OF THE ACT WOULD NOT INVALIDATE THE WHOLE.

It is alleged in the Brushaber bill (R. 24) (but not urged in his brief) that the Income Tax Law constitutes "one entire independent system of taxation," and that the invalidity of any provision or portion must be held to invalidate the entire act. Inasmuch as he has argued a point (discussed below) closely allied thereto—i. e., the invalidity of the entire assessment if a part shall be held invalid—the two questions, though distinct, are treated under a single caption.

1. Invalidity of a part does not invalidate the entire statute.

Even though, in respect to any particular objection, this court should find that Congress had exceeded its authority, nevertheless the act should, if possible, be sustained in all other respects.

The rule that, unless it *can not be presumed* that Congress would have legislated for the valid portions, even though it had been advised in advance of the invalidity of a part of a statute, the valid portions must stand, is too well known to require more than mere statement.

> *Cooley,* Constitutional Limitation, 7th ed. pp. 246, 247, 250.
>
> *Field* v. *Clark,* 143 U. S. 649.
>
> *Huntington* v. *Worthen,* 120 U. S. 97.

2. The Income-Tax Act SPECIFICALLY PROVIDES that the finding that a portion of the act is unconstitutional or void shall not invalidate the entire act.

The act of October 3, 1913, does not leave us to speculate upon the legislative will in this particular. Section 4, paragraph T, of the act of which the income-tax provision constitutes Section II, provides that:

> If any clause, sentence, paragraph, or part of this act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof,

directly involved in the controversy in which such judgment shall have been rendered.

No room, therefore, exists for doubt as to the legislative intent, which, as indicated in the cases above, is the chief if not the sole criterion.

3. Position of appellant, Brushaber, that the invalidity of a portion of the assessment (covering income for period prior to passage of the act) renders entire assessment for 1913 invalid, is untenable because (1) no assessment is before this court in this record and (2) none could be considered in that case.

The fifth point of appellant's brief (pp. 77 to 81) argues and cites cases to the effect that:

> Where * * * *no method appears whereby the legal element can be separated from that which is illegal,* the whole tax or the whole assessment, as the case may be, is void. [Italics ours.]

Appellant, Brushaber, may not in his case inquire whether the assessment showed the illegal portion separably from the valid portion. There *was no assessment* in his case. There is not the slightest reference in the record to any assessment actually made under the Income Tax Law against the Union Pacific Railroad Company or any other person for the year 1913, or for any period. Appellant at page 78 of his brief says:

> It will not, we think, be disputed by the Government that during the pendency of this suit (that) the commissioner did make an assessment upon the income of the de-

> fendant for the whole period of 10 months from March 1, 1913, to December 31, 1913, inclusive, without distinguishing in the assessment between the period preceding and that following October 3, 1913, and without any evidence as to the receipt of income by the defendant after October 3, 1913. This, we submit, makes the entire assessment for the year 1913 void and entitles the plaintiff to an injunction restraining the defendant from paying any part of the tax assessed for the said year.

There is nothing in the record supporting the statement of appellant—

(1) That an assessment was made,

(2) That it did not distinguish between the period preceding and that following October 3, 1913, and,

(3) That there was no evidence as to the receipt of income by the defendant after October 3, 1913.

This court has not, therefore, any basis of fact to which to apply the rule announced by Mr. Justice Harlan in the *Santa Clara County* case, cited by counsel for appellant in support of the fifth point of the brief.

Moreover, the matters stated in the Brushaber brief, as above, all transpired *after* the bill was filed in his case; and appellant made no attempt, by supplemental bill, to advance objection to any *particular* assessment. Indeed he could not have successfully done so. The theory of his bill was that no valid assessment could be made under the act upon any evidence, and because thereof he applied to the

court to prevent his directors from exercising a business discretion to pay the tax. This is a cause of action entirely apart from a complaint of non-separation of alleged invalid portion of an otherwise valid assessment made under authority of law.

The point is, however, properly presented in the Thorne and Tyee cases and argued by reference to the Brushaber brief.

CONCLUSION.

The decrees and judgments should be affirmed in all the cases.

THOMAS WATT GREGORY,
Attorney General.
JOHN W. DAVIS,
Solicitor General.
WILLIAM WALLACE, Jr.,
Assistant Attorney General.

OCTOBER, 1915.

APPENDIX.

INCOME TAX LAW.

[Section 2, act October 3, 1913; 38 Stat., 166 et seq.]

Normal tax, how levied.

A. Subdivision 1. That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere.

Additional tax on net incomes in excess of $20,000.

Subdivision 2. In addition to the income tax provided under this section (herein referred to as the normal income tax) there shall be levied, assessed, and collected upon the net income of every individual an additional income tax (herein referred to as the additional tax) of 1 per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000, and 2 per centum per annum upon the amount by which the total net income exceeds $50,000 and does not exceed $75,000, 3 per centum per annum upon the amount by which the total net income exceeds $75,000 and does not exceed $100,000, 4 per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $250,000, 5 per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $500,000, and 6 per centum per annum upon the amount by which the total net income exceeds $500,000. All the provisions of this section relating to individuals who are

chargeable with the normal income tax, so far as they are applicable and are not inconsistent with this subdivision of paragraph A, shall apply to the levy, assessment, and collection of the additional tax imposed under this section. Every person subject to this additional tax shall, for the purpose of its assessment and collection, make a personal return of his total net income from all sources, corporate or otherwise, for the preceding calendar year, under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. For the purpose of this additional tax the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies, or associations however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint-stock company, or association, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company, or association shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same if distributed.

Personal return of net income to be made annually.

Interest in gains and profits of corporations to be included.

Accumulated gains and profits beyond needs, how regarded.

B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income

Net income, items constituting same.

derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent: *Provided*, That the proceeds of life insurance policies paid upon the death of the person insured or payments made by or credited to the insured, on life insurance, endowment, or annuity contracts, upon the return thereof to the insured at the maturity of the term mentioned in the contract, or upon surrender of contract, shall not be included as income.

Property acquired by gift, etc., and life insurance paid or allowed, exempt.

That in computing net income for the purpose of the normal tax there shall be allowed as deductions: First, the necessary expenses actually paid in carrying on any business, not including personal, living, or family expenses; second, all interest paid within the year by a taxable person on indebtedness; third, all national, State, county, school, and municipal taxes paid within the year, not including those assessed against local benefits; fourth, losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise; fifth, debts due to the taxpayer actually ascertained to be worthless and charged off within the year; sixth, a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the computation is made, but no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided*, That no deduction shall be allowed for any amount paid out

Deductions allowed in computing net income for the purpose of the normal tax.

for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate; seventh, the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association, or insurance company which is taxable upon its net income as hereinafter provided; eighth, the amount of income, the tax upon which has been paid or withheld for payment at the source of the income, under the provisions of this section, provided that whenever the tax upon the income of a person is required to be withheld and paid at the source as hereinafter required, if such annual income does not exceed the sum of $3,000 or is not fixed or certain, or is indefinite, or irregular as to amount or time of accrual, the same shall not be deducted in the personal return of such person.

Net income of nonresidents, from property owned in United States.

The net income from property owned and business carried on in the United States by persons residing elsewhere shall be computed upon the basis prescribed in this paragraph and that part of paragraph G of this section relating to the computation of the net income of corporations, joint-stock and insurance companies, organized, created, or existing under the laws of foreign countries, in so far as applicable.

Interest on obligations of State or of United States and compensation of certain U. S. officers exempt from tax.

That in computing net income under this section there shall be excluded the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions; also the compensation of the present President of the United States during the term for which he has been elected, and of the judges of the supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State or any political subdivision thereof except when such compensation is paid by the United States Government.

Deduction of $3,000 allowed each single person, and $1,000 additional for married man and wife living together.

C. That there shall be deducted from the amount of the net income of each of said persons, ascertained as provided herein, the sum of $3,000, plus $1,000 additional if the person making the return be a married man with a wife living with him, or plus the sum of $1,000 additional if the person making the return be a married woman with

a husband living with her; but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife: *Provided*, That only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together.

Period for which tax is to be computed.

D. The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first: *Proviaed, however*, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions herein provided for. On or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, a true and accurate return, under oath or affirmation, shall be made by each person of lawful age, except as hereinafter provided, subject to the tax imposed by this section, and having a net income of $3,000 or over for the taxable year, to the collector of internal revenue for the district in which such person resides or has his principal place of business, or, in the case of a person residing in a foreign country, in the place where his principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources and from the total thereof, deducting the aggregate items or expenses and allowance herein authorized; guardians, trustees, executors, administrators, agents, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals: *Provided*, That a return made by one of two or more joint guardians, trustees, executors, administrators, agents,

Return to be made under oath by each person having a net income of $3,000 or over.

Gross income from all sources to be specified.

Guardians, trustees, etc., to make return for persons for whom they act.

receivers, and conservators, or other persons acting in a fiduciary capacity, filed in the district where such person resides, or in the district where the will or other instrument under which he acts is recorded, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph: and also all persons, firms, companies, copartnerships, corporations, joint-stock companies or associations, and insurance companies, except as hereinafter provided, in whatever capacity acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income of another person subject to tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal income tax upon the same and make and render a return, as aforesaid, but separate and distinct, of the portion of the income of each person from which the normal tax has been thus withheld, and containing also the name and address of such person or stating that the name and address or the address, as the case may be, are unknown: *Provided*, That the provision requiring the normal tax of individuals to be withheld at the source of the income shall not be construed to require any of such tax to be withheld prior to the first day of November, nineteen hundred and thirteen: *Provided further*, That in either case above mentioned no return of income not exceeding $3,000 shall be required: *Provided further*, That any persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid, under the provisions of this section, and any such firm, when requested by the Commissioner of Internal Revenue, or any district collector, shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same, if distributed: *Provided further*, That persons liable for the normal income tax only, on their own account or in behalf of another, shall not be required to make return

Persons, firms, etc., having control of determinable income payable to others.

Normal tax to be deducted and return thereof made.

No return required unless income exceeds $3,000.

Interest in partnership profits to be included in return.

Partnerships must submit statements when required.

of the income derived from dividends on the capital stock or from the net earnings of corporations, joint-stock companies or associations, and insurance companies taxable upon their net income as hereinafter provided. Any person for whom return has been made and the tax paid, or to be paid as aforesaid, shall not be required to make a return unless such person has other net income, but only one deduction of $3,000 shall be made in the case of any such person. The collector or deputy collector shall require every list to be verified by the oath or affirmation of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly. If dissatisfied with the decision of the collector, such person may submit the case, with all the papers, to the Commissioner of Internal Revenue for his decision, and may furnish sworn testimony of witnesses to prove any relevant facts.

Dividends on stock, when to be excluded from return.

Returns to be verified by oath, and amended returns may be required by collector.

Appeals from decision of collector.

E. That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid, and interest at the rate of 1 per centum per month upon said tax from the

Assessments, notice, and payments of.

Limitation as to time when assessment may be paid without incurring penalty.

Penalty and interest in case of nonpayment within 10 days after June 30th.

time the same became due, except from the estates of insane, deceased, or insolvent persons.

Persons, firms, etc., withholding normal tax on behalf of others.

All persons, firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual gains, profits, and income of another person, exceeding $3,000 for any taxable year, other than dividends on capital stock, or from the net earnings of corporations and joint-stock companies or associations subject to like tax, who are required to make and render a return in behalf of another, as provided herein, to the collector of his, her, or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this section, and shall pay to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax. In all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source, as aforesaid, such person shall not receive the benefit of the deduction and exemption allowed in paragraph C of this section except by an application for refund of the tax unless he shall, not less than thirty days prior to the day on which the return of his income is due, file with the person who is required to withhold and pay tax for him, a signed notice in writing claiming the benefit of such exemption and thereupon no tax shall be withheld upon the amount of such exemption: *Provided*, That if any person for the purpose of obtaining any allowance or reduction by virtue of a claim for such exemption, either for himself or for any other person, knowingly makes any false statement or false or fraudulent representation, he shall be liable to a penalty of $300; nor shall any person

Return to be made to collector of district.

Tax to be paid to officer authorized to receive same.

Notice must be filed in advance for claims for exemption under paragraph C.

Penalty for filing false claim.

under the foregoing conditions be allowed the benefit of any deduction provided for in subsection B of this section unless he shall, not less than thirty days prior to the day on which the return of his income is due, either file with the person who is required to withhold and pay tax for him a true and correct return of his annual gains, profits, and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the person required to withhold and pay the tax, or likewise make application for deductions to the collector of the district in which return is made or to be made for him: *Provided further*, That if such person is a minor or an insane person, or is absent from the United States, or is unable owing to serious illness to make the return and application above provided for, the return and application may be made for him or her by the person required to withhold and pay the tax, he making oath under the penalties of this Act that he has sufficient knowledge of the affairs and property of his beneficiary to enable him to make a full and complete return for him or her, and that the return and application made by him are full and complete: *Provided further*, That the amount of the normal tax hereinbefore imposed shall be deducted and withheld from fixed and determinable annual gains, profits, and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies or associations, and insurance companies, whether payable annually or at shorter or longer periods, although such interest does not amount to $3,000, subject to the provisions of this section requiring the tax to be withheld at the source and deducted from annual income and paid to the Government; and likewise the amount of such tax shall be deducted and withheld from coupons, checks, or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations,

Notice must be filed in advance for claim for deduction under paragraph B.

Returns, for minors, insane persons, etc., by whom made.

Normal tax to be deducted and withheld at source of income from bonds, etc., of corporations.

Dividends on stocks, or interest on foreign bonds, mortgages, etc.

and insurance companies engaged in business in foreign countries; and the tax in each case shall be withheld and deducted for and in behalf of any person subject to the tax hereinbefore imposed, although such interest, dividends, or other compensation does not exceed $3,000, by any banker or person who shall sell or otherwise realize coupons, checks, or bills of exchange drawn or made in payment of any such interest or dividends (not payable in the United States), and any person who shall obtain payment (not in the United States), in behalf of another of such dividends and interest by means of coupons, checks, or bills of exchange, and also any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States), otherwise than from a banker or another dealer in such coupons; but in each case the benefit of the exemption and the deduction allowable under this section may be had by complying with the foregoing provisions of this paragraph.

License to be obtained by persons, etc., engaged in business of collecting foreign payments of interest, etc.

All persons, firms, or corporations undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to ascertain and verify the due withholding and payment of the income tax required to be withheld and paid as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and any person who shall knowingly undertake to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding $5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

Penalty for failure to obtain license.

Liability for tax not affected by any contract entered into after passage of act.

Nothing in this section shall be construed to release a taxable person from liability for income tax, nor shall any contract entered into after this Act takes effect be valid in regard to any Federal income tax imposed upon a person liable to such payment.

The tax herein imposed upon annual gains, profits, and income not falling under the foregoing and not returned and paid by virtue of the foregoing shall be assessed by personal return under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury.

Deductions at source apply to normal tax only.

The provisions of this section relating to the deduction and payment of the tax at the source of income shall only apply to the normal tax hereinbefore imposed upon individuals.

Penalty for refusal or neglect to make required return or for making false return.

F. That if any person, corporation, joint-stock company, association, or insurance company liable to make the return or pay the tax aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, such person shall be liable to a penalty of not less than $20 nor more than $1,000. Any person or any officer of any corporation required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this section to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

Penalty for making false or fraudulent return.

Normal tax to be assessed and paid on annual net income of corporations, joint-stock companies and associations.

G. (a) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year: *Provided, however*, That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations oper-

Tax not to apply to certain organizations specified.

ating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members, nor to domestic building and loan associations, nor to cemetery companies, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, nor to business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare: *Provided further*, That there shall not be taxed under this section any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State, Territory, or the District of Columbia, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this Act, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate or maintain a public utility, no tax shall be levied under the provisions of this Act upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or cor-

Income derived from public utilities or governmental functions accruing to States, Territories, etc.

poration any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this section upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

Exemptions not to apply to gains or profits derived from contracts by persons or corporations.

(b) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such

Net income of corporations, joint-stock companies, etc., how ascertained.

Losses and depreciations.

Mutual fire insurance companies.

Mutual marine insurance companies.

amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest bearing indebtedness, and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year: *Provided*, That in case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation, joint-stock company, or association, the total interest secured and paid by such company, corporation, or association within the year on any such indebtedness may be deducted as a part of its expense of doing business: *Provided further*, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; and in the case of a bank, banking association, loan, or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country: *Provided*, That in the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income accrued within the year from business transacted and capital invested within the

Life insurance companies.

To what extent interest accruing and paid during the year on indebtedness may be deducted from income.

Bonds issued with guaranty that interest shall be free from taxation.

Interest on deposits may be deducted from gross income.

Taxes paid.

Foreign corporations, etc., income from business in United States.

United States, (first) all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year in business conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any, and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such

Ordinary expenses, rentals, etc.

Losses and depreciation.

Reserve funds of insurance companies.

Mutual fire insurance.

Mutual marine insurance.

Interest accruing and paid during the year on indebtedness.

year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding the proportion of one-half of the sum of its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital employed in the business at the close of the year which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided*, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof or the District of Columbia. In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

Bonds whose makers have agreed to pay interest without tax deduction.

Taxes.

Insurance reserve funds.

Tax to be computed on net income accruing each calendar year.

(c) The tax herein imposed shall be computed upon its entire net income accrued within each preceding calendar year ending December thirty-first: *Provided, however*, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be imposed upon its entire net income accrued within that portion of said year from March first to December thirty-first, both dates inclusive, to be ascertained by taking five-sixths of its entire net income for said calendar year: *Provided further*, That any corporation, joint-stock company or association, or insurance company subject to this tax may designate the last day of any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for

But fiscal year other than calendar may be designated by corporations.

the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the date upon which its annual return shall be filed. All corporations, joint-stock companies or associations, and insurance companies subject to the tax herein imposed, computing taxes upon the income of the calendar year, shall, on or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, and all corporations, joint-stock companies or associations, and insurance companies, computing taxes upon the income of a fiscal year which it may designate in the manner hereinbefore provided, shall render a like return within sixty days after the close of its said fiscal year, and within sixty days after the close of its fiscal year in each year thereafter, or in the case of a corporation, joint-stock company or association, or insurance company, organized or existing under the laws of a foreign country, in the place where its principal business is located within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, shall render a true and accurate return under oath or affirmation of its president, vice president, or other principal officer, and its treasurer or assistant treasurer, to the collector of internal revenue for the district in which it has its principal place of business, setting forth (*first*) the total amount of its paid-up capital stock outstanding, or if no capital stock, its capital employed in business, at the close of the year; (*second*) the total amount of its bonded and other indebtedness at the close of the year; (*third*) the gross amount of its income, received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and capital invested within the United States; (*fourth*) the total amount of all its ordinary and necessary expenses paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint-stock com-

Returns, when to be rendered.

Returns, under oath or affirmation to be filed with collector of district.

Information to be included in return of corporation.

Paid-up capital.

Bonded indebtedness.

Gross income.

Ordinary expenses of operation and maintenance.

Rental, etc.

pany or association, or insurance company within the year, stating separately all rentals or other payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States; (*fifth*) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; and in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States, not compensated

Losses and depreciation.

Additional reserve funds.

Certain premium deposits not to be returned as taxable income.

Premiums, reinsurance, etc.

Foreign corporations doing business in the United States.

by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (*sixth*) the amount of interest accrued and paid within the year on its bonded or other indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock, outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of indebtedness not exceeding the amount of capital employed in the business at the close of the year, and in the case of a bank, banking association, or trust company, stating separately all interest paid by it within the year on deposits; or in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign

Reserve fund.

Mutual fire insurance companies.

Mutual marine insurance companies.

Life insurance companies.

What interest on bonded indebtedness may be deducted.

Interest paid on deposits deductible from incomes.

country, interest so paid on its bonded or other indebtedness to an amount of such bonded or other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of capital employed in the business at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States; (*seventh*) the amount paid by it within the year for taxes imposed under the authority of the United States and separately the amount so paid by it for taxes imposed by the Government of any foreign country; (*eighth*) the net income of such corporation, joint-stock company or association, or insurance company, after making the deductions in this subsection authorized. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue.

Interest on indebtedness of foreign corporations.

Taxes paid.

Net income to be shown on return.

All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the thirtieth day of June: *Provided*, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and twenty days after the date upon which it is required to file its list or return of income for assessment; except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock

Assessments to be made, and notice to be given.

Assessed taxes, when to be paid by corporation, etc.

When false return has been rendered and facts are detected within 3 years, commissioner may make new assessment.

company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, or after one hundred and twenty days from the date on which the return of income is required to be made by the taxpayer, and after ten days notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid and interest at the rate of 1 per centum per month upon said tax from the time the same becomes due.

Penalty and interest incurred by failure to pay tax within prescribed time.

(d) When the assesment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: *Provided further*, That the proper officers of any State imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint stock company, association or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe.

Returns rendered to be filed with Commissioner of Internal Revenue

Returns to be open to inspection under certain conditions.

If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000.

Penalty to corporations, etc., for refusing or neglecting to file required return.

* * * * * * *

Section 4 (paragraph S) of the act of October 3, 1913, further provides * * * That a special excise tax with respect to the carrying on or doing of business, equivalent to 1 per centum upon their entire net income, shall

Income subject to special excise tax under act of Aug. 5, 1909.

be levied, assessed, and collected upon corporations, joint stock companies or association, and insurance companies, of the character described in section thirty-eight of the act of August fifth, nineteen hundred and nine, for the period from January first to February twenty-eighth, nineteen hundred and thirteen, both dates inclusive, which said tax shall be computed upon one-sixth of the entire net income of said corporations, joint stock companies or associations, and insurance companies, for said year, said net income to be ascertained in accordance with the provisions of subsection G of section two of this act: *Provided further*, That the provisions of said section thirty-eight of the act of August fifth, nineteen hundred and nine, relative to the collection of the tax therein imposed shall remain in force for the collection of the excise tax herein provided, but for the year nineteen hundred and thirteen it shall not be necessary to make more than one return and assessment for all the taxes imposed herein upon said corporations, joint stock companies or associations, and insurance companies, either by way of income or excise, which return and assessment shall be made at the times and in the manner provided in this act. * * *

One return may be filed for both special excise and income tax for year 1913.

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CASES ADJUDGED

IN THE

SUPREME COURT OF THE UNITED STATES

AT

OCTOBER TERM, 1915.

BRUSHABER *v.* UNION PACIFIC RAILROAD COMPANY.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

No. 140. Argued October 14, 15, 1915.—Decided January 24, 1916.

Under proper averments a stockholder's suit to restrain a corporation from voluntarily paying a tax charged to be unconstitutional, is not violative of Rev. Stat., § 3224, and the District Court has jurisdiction to entertain the action: *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429.

In this case—that of a stockholder against a corporation to restrain the latter from voluntarily paying the income tax imposed by the Tariff Act of 1913,—the defendant corporation notified the Government of the pendency of the action, and the United States was heard as *amicus curiæ* in support of the constitutionality of the Act.

The Sixteenth Amendment was obviously intended to simplify the situation and make clear the limitations on the taxing power of Congress and not to create radical and destructive changes in our constitutional system.

The Sixteenth Amendment does not purport to confer power to levy income taxes in a generic sense, as that authority was already pos-

sessed, or to limit and distinguish between one kind of income tax and another; but its purpose is to relieve all income taxes when imposed from apportionment from consideration of the source whence the income is derived.

The Income Tax provisions of the Tariff Act of 1913 are not unconstitutional by reason of retroactive operation, the period covered not extending prior to the time when the Amendment was operative; nor are those provisions unconstitutional under the due process provision of the Fifth Amendment; nor do they deny due process of law, nor equal protection of the law by reason of the classifications therein of things or persons subject to the tax.

The provisions for collecting income at the source do not deny due process of law by reason of duties imposed upon corporations without compensation in connection with the payment of the tax by others.

The uniformity of taxation required by the Federal Constitution is geographical. *Knowlton* v. *Moore*, 178 U. S. 41.

The Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution.

Arguments as to the expediency of levying a tax which is within the power of Congress to levy are beyond judicial cognizance.

When there are differences between the subjects that are taxed, Congress does not transcend the limit of its taxing power by taxing them differently.

A want of due process of law does not arise from want of wisdom in Congress in levying taxes and thus give the courts power to overrule the action of Congress by declaring it to be unconstitutional.

THE facts, which involve the construction of the Sixteenth Amendment and other provisions of the Constitution of the United States, and the constitutionality of the Income Tax provisions of the Tariff Act of October 9, 1913, are stated in the opinion.

Mr. Julien T. Davies, with whom *Mr. Brainard Tolles*, *Mr. Garrard Glenn* and *Mr. Martin A. Schenck* were on the brief, for the appellant:

The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the States, in its application to a general and uniform tax

upon incomes from whatever source derived. The Income Tax Law of 1913, except in so far as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.

So much of the act of 1913, as subjects certain corporate earnings to the normal tax of one per cent. as income of the operating corporation, and again subjects the same earnings to a like tax while in process of distribution to the beneficial owners through the instrumentality of an intermediate corporation, operates as a discrimination in the nature of a penalty on corporations holding stock in other corporations and necessarily conflicts with the right of the several States to determine for themselves the permissible forms and modes of ownership of property.

The provisions complained of constitute a departure from the general plan of the act.

Holding stock in other corporations is not a legitimate basis of classification in a Federal tax law.

The authorities condemn arbitrary selection under the guise of classification.

The provisions of the statute which require collection at the source by corporations, debtors, fiduciaries and employers involve the taking of property without due process of law and the taking of private property for public use without compensation and are invalid.

Unapportioned compulsory service is not a tax.

Provision for just compensation is essential.

The act not only exacts labor without compensation, but exposes one collecting the income at the source to unnecessary risks and perils.

The act involves unreasonable discriminations and arbitrary classification.

The statute is invalid in the particular of seeking to tax income received prior to October 3, 1913.

The entire assessment of income tax against the defendant for the year 1913 is invalidated by the inclusion therein of the amount improperly assessed relative to the income received between March 1, 1913, and October 3, 1913.

In support of these contentions, see *Alexandria Canal Co.* v. *District of Columbia*, 1 Mackey, 217; 5 Mackey, 376; *Atlantic Coast Line* v. *Goldsboro*, 232 U. S. 548; *Attorney General* v. *Old Colony R. R.*, 160 Massachusetts, 62; *Barnes* v. *Railroads*, 17 Wall. 294; *Biddle's Appeal*, 97 Pa. St. 278; *In re Chapman*, 166 U. S. 661; *Chicago, B. & Q. Ry.* v. *Chicago*, 166 U. S. 226; *Chicago, M. & St. P. R. R.* v. *Wisconsin*, 238 U. S. 491; *Clarke* v. *Strickland*, 2 Curt. 439; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540; *Consolidated Rendering Co.* v. *Vermont*, 207 U. S. 541; *Santa Clara County* v. *Southern Pacific R. R.*, 18 Fed. Rep. 385; *S. C.*, 118 U. S. 394; *San Mateo County* v. *Southern Pacific R. R.*, 13 Fed. Rep. 145; *In re Farrell*, 212 Fed. Rep. 212; *Freeland* v. *Hastings*, 10 Allen, 570; *Goodwin* v. *McGaughey*, 108 Minnesota, 248; *Gray* v. *Darlington*, 15 Wall. 63; *Guy* v. *Baltimore*, 100 U. S. 434; *Haight* v. *Railroad Co.*, 6 Wall. 15; *James* v. *Campbell*, 104 U. S. 356; *Johnson* v. *Colburn*, 36 Vermont, 693; *Joyner* v. *Third School District*, 3 Cush. 567; *Kalbach* v. *Clark*, 133 Iowa, 215; *Kilbourn* v. *Thompson*, 103 U. S. 168; *Lacey* v. *Davis*, 4 Michigan, 140; *Lake Shore R. Co.* v. *Smith*, 173 U. S. 684; *Libby* v. *Burnham*, 15 Massachusetts, 144; *Loan Assn.* v. *Topeka*, 20 Wall. 655; *Louis. & Nash. R. R.* v. *Stockyards*, 212 U. S. 132; *McCoach* v. *Minehill Ry.*, 228 U. S. 295; *McCulloch* v. *Maryland*, 4 Wheat. 316; *McCully* v. *Railroad*, 212 Missouri, 1; *Magoun* v. *Illinois Savings Bank*, 170 U. S. 283; *Mayor* v. *Cooper*, 131 Georgia, 670; *Merchants' Bank* v. *Pennsylvania*, 167 U. S. 461; *Merchants' Ins. Co.* v. *McCartney*, 1 Lowell, 447; *Minnesota Rate Cases*, 230 U. S. 352; *Mo. Pac. R. R.* v. *Larabbee Mills*, 211 U. S. 612; *National Deposit Co.* v. *Stead*, 232 U. S. 58; *New*

Jersey v. *Anderson*, 203 U. S. 483; *Pembina Mining Co.* v. *Pennsylvania*, 125 U. S. 181; *Cornell* v. *Davenport*, 30 Hun, 177; *Pollock* v. *Farmers' L. & T. Co.*, 158 U. S. 601; *Richards* v. *Washington Terminal*, 233 U. S. 546; *San Bernardino County* v. *Southern Pacific R. R.*, 118 U. S. 417; *Scholey* v. *Rew*, 23 Wall. 331; *Southern Ry.* v. *Greene*, 216 U. S. 400; *Stetson* v. *Kempton*, 13 Massachusetts, 272; *Stockdale* v. *Insurance Cos.*, 20 Wall. 323; *Sturges* v. *Crowninshield*, 4 Wheat. 122; *Sun Mutual Ins. Co.* v. *Mayor*, 8 N. Y. 241; *Toone* v. *The State*, 178 Alabama, 70; *Union Bank* v. *Chicago*, 3 Biss. 82; *United States* v. *Buffalo Pitts Co.*, 234 U. S. 228; *United States* v. *Fox*, 95 U. S. 670; *United States* v. *Harris*, 106 U. S. 629; *United States* v. *Mitchell*, 58 Fed. Rep. 993; *United States* v. *Singer*, 15 Wall. 111; *United States* v. *Railroad Co.*, 17 Wall. 322; *United States* v. *Welch*, 217 U. S. 333; *Ward* v. *Maryland*, 12 Wall. 418; *Worthen* v. *Badgett*, 32 Arkansas, 496.

The Solicitor General and *Mr. Assistant Attorney General Wallace* for the United States, as *amicus curiæ*, by leave of the court, in support of the decree appealed from:

Sections 3224 and 3226, Rev. Stat., preclude this remedy and leave this court without jurisdiction of this action. These statutes are constitutional. *Murray's Lessee* v. *Hoboken L. & I. Co.*, 18 How. 272, 282; *Nichols* v. *United States*, 7 Wall. 122; *United States* v. *Pacific Railroad*, 4 Dillon, 66; *Snyder* v. *Marks*, 109 U. S. 189; *Shelton* v. *Platt*, 139 U. S. 591; *Allen* v. *Pullman Car Co.*, 139 U. S. 658; *Straus* v. *Abrast Realty Co.*, 200 Fed. Rep. 327; *Corbus* v. *Gold Mining Co.*, 187 U. S. 455, 459; *Hawes* v. *Oakland*, 104 U. S. 450.

Taxes, when laid on income derived from realty or invested personalty, are direct taxes and before the Sixteenth Amendment were not subject to the rule of uniformity. *Pollock* v. *Farmers' L. & T. Co.*, 157 U. S. 557; *Spreckels*

Sugar Co. v. *McLean*, 192 U. S. 397, 413; *License Tax Cases*, 5 Wall. 462, 471; *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 177; *Southern Ry.* v. *King*, 217 U. S. 534; *Hatch* v. *Reardon*, 204 U. S. 160.

The Sixteenth Amendment removed the restriction of apportionment as to such income taxes as before were subject thereto.

The Constitution does not impose any implied or inherent rule of uniformity on the taxing power. *Pollock* v. *Farmers' L. & T. Co.*, *supra*, 557; *License Tax Cases*, *supra*, 462, 471; *Patton* v. *Brady*, 184 U. S. 608; *McCray* v. *United States*, 195 U. S. 27; *Flint* v. *Stone Tracy Co.*, *supra*.

Nor can such requirement be developed from the due process clause of the Fifth Amendment; or the due process or equal protection clauses of the Fourteenth Amendment. *Billings* v. *United States*, 232 U. S. 261, 282.

The rule of general uniformity is not violated by exemption, classification or discrimination, unless so arbitrary or outrageous as to indicate favoritism or prejudice. *Knowlton* v. *Moore*, 178 U. S. 41; *Flint* v. *Stone Tracy Co.*, *supra*, 107; *Cook* v. *Marshall County*, 196 U. S. 261, 274; *Nicol* v. *Ames*, 173 U. S. 509, 521.

The express uniformity clause requires not intrinsic, but only geographical uniformity. *Knowlton* v. *Moore*, *supra*, 106; *Billings* v. *United States*, *supra*, 282.

Neither the Fifth nor the Fourteenth Amendment, if operative, would forbid reasonable exemption, classification or discrimination. *Dist. of Col.* v. *Brooke*, 214 U. S. 138, 150; *Second Employers' Liability Cases*, 223 U. S. 1, 52, 53; *Barrett* v. *Indiana*, 229 U. S. 26, 29; *Int. Harvester Co.* v. *Missouri*, 234 U. S. 199, 214, 215; *Metropolis Theatre Co.* v. *Chicago*, 228 U. S. 61, 69; *Lindsley* v. *Natural Gas Co.*, 220 U. S. 61, 78; *Gibbons* v. *Dist. of Col.*, 116 U. S. 404; *Beers* v. *Glynn*, 211 U. S. 477; *Magoun* v. *Illinois Sav. Bank*, 170 U. S. 299; *Welch* v. *Cook*, 97 U. S. 541; *Home*

of the Friendless v. *Rouse*, 8 Wall. 430; *Salt Co.* v. *East Saginaw*, 13 Wall. 373.

Reasonable selection and classification is peculiarly a function of the Congress. Cooley on Const. Lim., 3d ed., 739; *Pacific Ins. Co.* v. *Soule*, 7 Wall. 433; *McCray* v. *United States*, 195 U. S. 27, 57, 61; *Veazie Bank* v. *Fenno*, 8 Wall. 548; *Treat* v. *White*, 181 U. S. 264, 269; *Flint* v. *Stone Tracy Co., supra*, 167; *Lindsley* v. *Natural Gas Co., supra*, 78; *Int. Harvester Co.* v. *Missouri, supra*, 215; *Barrett* v. *Indiana, supra*, 29, 30; *Nicol* v. *Ames, supra*, 521.

Those assailing a legislative classification carry the burden of demonstrating its unreasonableness. *Nicol* v. *Ames, supra*, 514, 515; *Lindsley* v. *Natural Gas Co., supra*, 78, 79.

None of the exemptions or discriminations here complained of are unreasonable, nor do they produce lack of uniformity. *Flint* v. *Stone Tracy Co., supra*, 178; *Home of the Friendless* v. *Rouse, supra; Salt Co.* v. *East Saginaw, supra; Gibbons* v. *District of Columbia, supra; Knowlton* v. *Moore, supra*, 109; *Peacock* v. *Pratt*, 121 Fed. Rep. 772, 777; *Pollock* v. *Farmers' L. & T. Co., supra*, 675, 676.

They were all within the power of selection and classification.

For taxation purposes there are fundamental distinctions between individuals and corporations. Black on Income Taxes, 28; *Flint* v. *Stone Tracy Co., supra*, 158, 161; *Nicol* v. *Ames, supra*, 521; *Kentucky R. R. Tax Cases*, 115 U. S. 321, 337, 339; *Pacific Exp. Co.* v. *Seibert*, 142 U. S. 339, 354; *Income Tax Cases*, 148 Wisconsin, 456.

Capital stock held by corporations may be distinguished from that held by individuals. *Tennessee* v. *Whitworth*, 117 U. S. 129, 136, 137; *New Orleans* v. *Citizens' Bank*, 167 U. S. 371; *Powers* v. *Detroit &c. Ry.*, 201 U. S. 543, 559, 560; *Flint* v. *Stone Tracy Co., supra*, 150.

There is no objectionable discrimination in the provi-

sion allowing deductions of interest paid. *Flint* v. *Stone Tracy Co., supra*, 169, 171.

This tax is not an infraction of the state power to authorize formation of corporations, etc. *Flint* v. *Stone Tracy Co., supra*, 152, 153, 158.

The "source collection" provisions are valid. *Bank* v. *Commonwealth*, 9 Wall. 353, 363; *Home Savings Bank* v. *Des Moines*, 205 U. S. 503; Cooley on Taxation (3d ed.), 832, 834; *Patton* v. *Brady*, 184 U. S. 608, 620, 621; *Bell's Gap R. R.* v. *Pennsylvania*, 134 U. S. 232, 239; *Cummings* v. *National Bank*, 101 U. S. 153, 156; *National Deposit Co.* v. *Illinois*, 232 U. S. 58, 70; Gray on Limitations of Taxing Power, § 1196; *Aberdeen Bank* v. *Chehalis County*, 166 U. S. 440, 444; *Merchants' Bank* v. *Pennsylvania*, 167 U. S. 461, 465; *Carstairs* v. *Cochran*, 193 U. S. 10; *Union Bank* v. *Richmond*, 94 Virginia, 316; *Commonwealth* v. *Citizens' Bank*, 117 Kentucky, 946.

The so-called retroactive feature is not objectionable. Previous statutes had like provisions. 12 Stat. 292, 473, 474; 13 Stat. 223, 281, 283, 417; 14 Stat. 471, 478, 480; 16 Stat. 256; 28 Stat. 553, § 27; Chap. 35, 5 & 6 Vict.; c. 34, 16 & 17 Vict.; 16 Halsb. Laws of England, 609; sub-sec. 4, English Finance Act of 1910; § 38, English Finance Act of 1894; *Drexel* v. *Commonwealth*, 46 Pa. St. 31, 40; *Stockdale* v. *Insurance Cos.*, 20 Wall. 323, 331, 341; *Income Tax Cases*, 148 Wisconsin, 456; Cooley on Taxation (3d ed.), pp. 492, 493, 494; *Locke* v. *New Orleans*, 4 Wall. 172; *Gray* v. *Darlington*, 15 Wall. 63, 66; *Maine* v. *Grand Trunk Ry.*, 142 U. S. 217; *Patton* v. *Brady*, 184 U. S. 608; *Flint* v. *Stone Tracy Co., supra*, 108.

There is no invalid delegation of judicial authority to the Secretary of the Treasury. *Murray's Lessee* v. *Hoboken L. & I. Co.*, 18 How. 272; *Fong Yeu Ting* v. *United States*, 149 U. S. 698, 714; *Lem Moon Sing* v. *United States*, 158 U. S. 538, 544; *Nishimura Ekiu* v. *United States*, 142 U. S. 651, 660; *United States* v. *Duell*, 172 U. S.

576, 586; *Butterworth* v. *Hoe*, 112 U. S. 50, 67; *Runkle* v. *United States*, 122 U. S. 543, 557; *United States* v. *Ju Toy*, 198 U. S. 253; *Tang Tun* v. *Edsell*, 223 U. S. 673; *United States* v. *Sing Tuck*, 194 U. S. 161, 170; *Japanese Immigrant Case*, 189 U. S. 86, 98; *Turner* v. *Williams*, 194 U. S. 279; *Chin Bak Kan* v. *United States*, 186 U. S. 193; *Fok Yung Yo* v. *United States*, 185 U. S. 296; *Union Bridge Co.* v. *United States*, 204 U. S. 364, 386; *Buttfield* v. *Stranahan*, 192 U. S. 470; *Oceanic Navigation Co.* v. *Stranahan*, 214 U. S. 320.

This act is separable by its own express provisions, and the entire statute could not fail even were there partial invalidity. Section 4, par. T, Act of Oct. 3, 1913, 38 Stat. 166 *et seq.*; Cooley on Const. Lim. (7th ed.), 246, 247, 250; *Field* v. *Clark*, 143 U. S. 649; *Huntington* v. *Worthen*, 120 U. S. 97.

There was no argument on behalf of appellee.

MR. CHIEF JUSTICE WHITE delivered the opinion of the court.

As a stockholder of the Union Pacific Railroad Company the appellant filed his bill to enjoin the corporation from complying with the Income Tax provisions of the Tariff Act of October 3, 1913, (§ II, ch. 16, 38 Stat. 166). Because of constitutional questions duly arising the case is here on direct appeal from a decree sustaining a motion to dismiss because no ground for relief was stated.

The right to prevent the corporation from returning and paying the tax was based upon many averments as to the repugnancy of the statute to the Constitution of the United States, of the peculiar relation of the corporation to the stockholders and their particular interests resulting from many of the administrative provisions of the assailed act, of the confusion, wrong and multiplicity

of suits and the absence of all means of redress which would result if the corporation paid the tax and complied with the act in other respects without protest, as it was alleged it was its intention to do. To put out of the way a question of jurisdiction we at once say that in view of these averments and the ruling in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, sustaining the right of a stockholder to sue to restrain a corporation under proper averments from voluntarily paying a tax charged to be unconstitutional on the ground that to permit such a suit did not violate the prohibitions of § 3224, Rev. Stat., against enjoining the enforcement of taxes, we are of opinion that the contention here made that there was no jurisdiction of the cause since to entertain it would violate the provisions of the Revised Statutes referred to is without merit. Before coming to dispose of the case on the merits, however, we observe that the defendant corporation having called the attention of the Government to the pendency of the cause and the nature of the controversy and its unwillingness to voluntarily refuse to comply with the act assailed, the United States as *amicus curiæ* has at bar been heard both orally and by brief for the purpose of sustaining the decree.

Aside from averments as to citizenship and residence, recitals as to the provisions of the statute and statements as to the business of the corporation contained in the first ten paragraphs of the bill advanced to sustain jurisdiction, the bill alleged twenty-one constitutional objections specified in that number of paragraphs or subdivisions. As all the grounds assert a violation of the Constitution, it follows that in a wide sense they all charge a repugnancy of the statute to the Sixteenth Amendment under the more immediate sanction of which the statute was adopted.

The various propositions are so intermingled as to cause it to be difficult to classify them. We are of opinion, how-

ever, that the confusion is not inherent, but rather arises from the conclusion that the Sixteenth Amendment provides for a hitherto unknown power of taxation, that is, a power to levy an income tax which although direct should not be subject to the regulation of apportionment applicable to all other direct taxes. And the far-reaching effect of this erroneous assumption will be made clear by generalizing the many contentions advanced in argument to support it, as follows: (a) The Amendment authorizes only a particular character of direct tax without apportionment, and therefore if a tax is levied under its assumed authority which does not partake of the characteristics exacted by the Amendment, it is outside of the Amendment and is void as a direct tax in the general constitutional sense because not apportioned. (b) As the Amendment authorizes a tax only upon incomes "from whatever source derived," the exclusion from taxation of some income of designated persons and classes is not authorized and hence the constitutionality of the law must be tested by the general provisions of the Constitution as to taxation, and thus again the tax is void for want of apportionment. (c) As the right to tax "incomes from whatever source derived" for which the Amendment provides must be considered as exacting intrinsic uniformity, therefore no tax comes under the authority of the Amendment not conforming to such standard, and hence all the provisions of the assailed statute must once more be tested solely under the general and preëxisting provisions of the Constitution, causing the statute again to be void in the absence of apportionment. (d) As the power conferred by the Amendment is new and prospective, the attempt in the statute to make its provisions retroactively apply is void because so far as the retroactive period is concerned, it is governed by the preëxisting constitutional requirement as to apportionment.

But it clearly results that the proposition and the con-

tentions under it, if acceded to, would cause one provision of the Constitution to destroy another; that is, they would result in bringing the provisions of the Amendment exempting a direct tax from apportionment into irreconcilable conflict with the general requirement that all direct taxes be apportioned. Moreover, the tax authorized by the Amendment, being direct, would not come under the rule of uniformity applicable under the Constitution to other than direct taxes, and thus it would come to pass that the result of the Amendment would be to authorize a particular direct tax not subject either to apportionment or to the rule of geographical uniformity, thus giving power to impose a different tax in one State or States than was levied in another State or States. This result instead of simplifying the situation and making clear the limitations on the taxing power, which obviously the Amendment must have been intended to accomplish, would create radical and destructive changes in our constitutional system and multiply confusion.

But let us by a demonstration of the error of the fundamental proposition as to the significance of the Amendment dispel the confusion necessarily arising from the arguments deduced from it. Before coming, however, to the text of the Amendment, to the end that its significance may be determined in the light of the previous legislative and judicial history of the subject with which the Amendment is concerned and with a knowledge of the conditions which presumptively led up to its adoption and hence of the purpose it was intended to accomplish, we make a brief statement on those subjects.

That the authority conferred upon Congress by § 8 of Article I "to lay and collect taxes, duties, imposts and excises" is exhaustive and embraces every conceivable power of taxation has never been questioned, or, if it has, has been so often authoritatively declared as to render it necessary only to state the doctrine. And it has also never

been questioned from the foundation, without stopping presently to determine under which of the separate headings the power was properly to be classed, that there was authority given, as the part was included in the whole, to lay and collect income taxes. Again it has never moreover been questioned that the conceded complete and all-embracing taxing power was subject, so far as they were respectively applicable, to limitations resulting from the requirements of Art. I, § 8, cl. 1, that "all duties, imposts and excises shall be uniform throughout the United States," and to the limitations of Art. I, § 2, cl. 3, that "direct taxes shall be apportioned among the several States" and of Art. I, § 9, cl. 4, that "no capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken." In fact the two great subdivisions embracing the complete and perfect delegation of the power to tax and the two correlated limitations as to such power were thus aptly stated by Mr. Chief Justice Fuller in *Pollock* v. *Farmers' Loan & Trust Company, supra,* at page 557: "In the matter of taxation, the Constitution recognizes the two great classes of direct and indirect taxes, and lays down two rules by which their imposition must be governed, namely: The rule of apportionment as to direct taxes, and the rule of uniformity as to duties, imposts and excises." It is to be observed, however, as long ago pointed out in *Veazie Bank* v. *Fenno,* 8 Wall. 533, 541, that the requirement of apportionment as to one of the great classes and of uniformity as to the other class were not so much a limitation upon the complete and all embracing authority to tax, but in their essence were simply regulations concerning the mode in which the plenary power was to be exerted. In the whole history of the Government down to the time of the adoption of the Sixteenth Amendment, leaving aside some conjectures expressed of the possibility of a tax lying intermediate between the two great classes and embraced

by neither, no question has been anywhere made as to the correctness of these propositions. At the very beginning, however, there arose differences of opinion concerning the criteria to be applied in determining in which of the two great subdivisions a tax would fall. Without pausing to state at length the basis of these differences and the consequences which arose from them, as the whole subject was elaborately reviewed in *Pollock* v. *Farmers' Loan & Trust Company*, 157 U. S. 429; 158 U. S. 601, we make a condensed statement which is in substance taken from what was said in that case. Early the differences were manifested in pressing on the one hand and opposing on the other, the passage of an act levying a tax without apportionment on carriages "for the conveyance of persons," and when such a tax was enacted the question of its repugnancy to the Constitution soon came to this court for determination. (*Hylton* v. *United States*, 3 Dall. 171.) It was held that the tax came within the class of excises, duties and imposts and therefore did not require apportionment, and while this conclusion was agreed to by all the members of the court who took part in the decision of the case, there was not an exact coincidence in the reasoning by which the conclusion was sustained. Without stating the minor differences, it may be said with substantial accuracy that the divergent reasoning was this: On the one hand, that the tax was not in the class of direct taxes requiring apportionment because it was not levied directly on property because of its ownership but rather on its use and was therefore an excise, duty or impost; and on the other, that in any event the class of direct taxes included only taxes directly levied on real estate because of its ownership. Putting out of view the difference of reasoning which led to the concurrent conclusion in the *Hylton Case*, it is undoubted that it came to pass in legislative practice that the line of demarcation between the two great classes of direct taxes on the one hand and excises, duties and

imposts on the other which was exemplified by the ruling in that case, was accepted and acted upon. In the first place this is shown by the fact that wherever (and there were a number of cases of that kind) a tax was levied directly on real estate or slaves because of ownership, it was treated as coming within the direct class and apportionment was provided for, while no instance of apportionment as to any other kind of tax is afforded. Again the situation is aptly illustrated by the various acts taxing incomes derived from property of every kind and nature which were enacted beginning in 1861 and lasting during what may be termed the Civil War period. It is not disputable that these latter taxing laws were classed under the head of excises, duties and imposts because it was assumed that they were of that character inasmuch as although putting a tax burden on income of every kind, including that derived from property real or personal, they were not taxes directly on property because of its ownership. And this practical construction came in theory to be the accepted one since it was adopted without dissent by the most eminent of the textwriters. 1 Kent Com. 254, 256; 1 Story Const., § 955; Cooley Const. Lim. (5th ed.) *480; Miller on the Constitution, 237; Pomeroy's Constitutional Law, § 281; Hare Const. Law, Vol. 1, 249, 250; Burroughs on Taxation, 502; Ordronaux, Constitutional Legislation, 225.

Upon the lapsing of a considerable period after the repeal of the income tax laws referred to, in 1894 an act was passed laying a tax on incomes from all classes of property and other sources of revenue which was not apportioned, and which therefore was of course assumed to come within the classification of excises, duties and imposts which were subject to the rule of uniformity but not to the rule of apportionment. The constitutional validity of this law was challenged on the ground that it did not fall within the class of excises, duties and imposts,

but was direct in the constitutional sense and was therefore void for want of apportionment, and that question came to this court and was passed upon in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601. The court, fully recognizing in the passage which we have previously quoted the all-embracing character of the two great classifications including, on the one hand, direct taxes subject to apportionment, and on the other, excises, duties and imposts subject to uniformity, held the law to be unconstitutional in substance for these reasons: Concluding that the classification of direct was adopted for the purpose of rendering it impossible to burden by taxation accumulations of property, real or personal, except subject to the regulation of apportionment, it was held that the duty existed to fix what was a direct tax in the constitutional sense so as to accomplish this purpose contemplated by the Constitution. (157 U. S. 581.) Coming to consider the validity of the tax from this point of view, while not questioning at all that in common understanding it was direct merely on income and only indirect on property, it was held that considering the substance of things it was direct on property in a constitutional sense since to burden an income by a tax was from the point of substance to burden the property from which the income was derived and thus accomplish the very thing which the provision as to apportionment of direct taxes was adopted to prevent. As this conclusion but enforced a regulation as to the mode of exercising power under particular circumstances, it did not in any way dispute the all-embracing taxing authority possessed by Congress, including necessarily therein the power to impose income taxes if only they conformed to the constitutional regulations which were applicable to them. Moreover in addition the conclusion reached in the *Pollock Case* did not in any degree involve holding that income taxes generically and necessarily came within the class

of direct taxes on property, but on the contrary recognized the fact that taxation on income was in its nature an excise entitled to be enforced as such unless and until it was concluded that to enforce it would amount to accomplishing the result which the requirement as to apportionment of direct taxation was adopted to prevent, in which case the duty would arise to disregard form and consider substance alone and hence subject the tax to the regulation as to apportionment which otherwise as an excise would not apply to it. Nothing could serve to make this clearer than to recall that in the *Pollock Case* in so far as the law taxed incomes from other classes of property than real estate and invested personal property, that is, income from "professions, trades, employments, or vocations" (158 U. S. 637), its validity was recognized; indeed it was expressly declared that no dispute was made upon that subject and attention was called to the fact that taxes on such income had been sustained as excise taxes in the past. *Id.*, p. 635. The whole law was however declared unconstitutional on the ground that to permit it to thus operate would relieve real estate and invested personal property from taxation and "would leave the burden of the tax to be borne by professions, trades, employments, or vocations; and in that way what was intended as a tax on capital would remain, in substance, a tax on occupations and labor," (*Id.*, p. 637) a result which it was held could not have been contemplated by Congress.

This is the text of the Amendment:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

It is clear on the face of this text that it does not purport to confer power to levy income taxes in a generic sense—an authority already possessed and never ques-

tioned—or to limit and distinguish between one kind of income taxes and another, but that the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived. Indeed in the light of the history which we have given and of the decision in the *Pollock Case* and the ground upon which the ruling in that case was based, there is no escape from the conclusion that the Amendment was drawn for the purpose of doing away for the future with the principle upon which the *Pollock Case* was decided, that is, of determining whether a tax on income was direct not by a consideration of the burden placed on the taxed income upon which it directly operated, but by taking into view the burden which resulted on the property from which the income was derived, since in express terms the Amendment provides that income taxes, from whatever source the income may be derived, shall not be subject to the regulation of apportionment. From this in substance it indisputably arises, first, that all the contentions which we have previously noticed concerning the assumed limitations to be implied from the language of the Amendment as to the nature and character of the income taxes which it authorizes find no support in the text and are in irreconcilable conflict with the very purpose which the Amendment was adopted to accomplish. Second, that the contention that the Amendment treats a tax on income as a direct tax although it is relieved from apportionment and is necessarily therefore not subject to the rule of uniformity as such rule only applies to taxes which are not direct, thus destroying the two great classifications which have been recognized and enforced from the beginning, is also wholly without foundation since the command of the Amendment that all income taxes shall not be subject to apportionment by a consideration of the sources from which the taxed income may be derived,

forbids the application to such taxes of the rule applied in the *Pollock Case* by which alone such taxes were removed from the great class of excises, duties and imposts subject to the rule of uniformity and were placed under the other or direct class. This must be unless it can be said that although the Constitution as a result of the Amendment in express terms excludes the criterion of source of income, that criterion yet remains for the purpose of destroying the classifications of the Constitution by taking an excise out of the class to which it belongs and transferring it to a class in which it cannot be placed consistently with the requirements of the Constitution. Indeed, from another point of view, the Amendment demonstrates that no such purpose was intended and on the contrary shows that it was drawn with the object of maintaining the limitations of the Constitution and harmonizing their operation. We say this because it is to be observed that although from the date of the *Hylton Case* because of statements made in the opinions in that case it had come to be accepted that direct taxes in the constitutional sense were confined to taxes levied directly on real estate because of its ownership, the Amendment contains nothing repudiating or challenging the ruling in the *Pollock Case* that the word direct had a broader significance since it embraced also taxes levied directly on personal property because of its ownership, and therefore the Amendment at least impliedly makes such wider significance a part of the Constitution—a condition which clearly demonstrates that the purpose was not to change the existing interpretation except to the extent necessary to accomplish the result intended, that is, the prevention of the resort to the sources from which a taxed income was derived in order to cause a direct tax on the income to be a direct tax on the source itself and thereby to take an income tax out of the class of excises, duties and imposts and place it in the class of direct taxes.

We come then to ascertain the merits of the many contentions made in the light of the Constitution as it now stands, that is to say, including within its terms the provisions of the Sixteenth Amendment as correctly interpreted. We first dispose of two propositions assailing the validity of the statute on the one hand because of its repugnancy to the Constitution in other respects, and especially because its enactment was not authorized by the Sixteenth Amendment.

The statute was enacted October 3, 1913, and provided for a general yearly income tax from December to December of each year. Exceptionally, however, it fixed a first period embracing only the time from March 1, to December 31, 1913, and this limited retroactivity is assailed as repugnant to the due process clause of the Fifth Amendment and as inconsistent with the Sixteenth Amendment itself. But the date of the retroactivity did not extend beyond the time when the Amendment was operative, and there can be no dispute that there was power by virtue of the Amendment during that period to levy the tax, without apportionment, and so far as the limitations of the Constitution in other respects are concerned, the contention is not open, since in *Stockdale* v. *Insurance Companies*, 20 Wall. 323, 331, in sustaining a provision in a prior income tax law which was assailed because of its retroactive character, it was said:

"The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, cannot be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed. The joint resolution of July 4th, 1864, imposed a tax of five per cent. upon all income of the previous year, although one tax on it had already been paid, and no one doubted the validity of the tax or attempted to resist it."

The statute provides that the tax should not apply to enumerated organizations or corporations, such as labor, agricultural or horticultural organizations, mutual savings banks, etc., and the argument is that as the Amendment authorized a tax on incomes "from whatever source derived," by implication it excluded the power to make these exemptions. But this is only a form of expressing the erroneous contention as to the meaning of the Amendment, which we have already disposed of. And so far as this alleged illegality is based on other provisions of the Constitution, the contention is also not open, since it was expressly considered and disposed of in *Flint* v. *Stone Tracy Co.*, 220 U. S. 108, 173.

Without expressly stating all the other contentions, we summarize them to a degree adequate to enable us to typify and dispose of all of them.

1. The statute levies one tax called a normal tax on all incomes of individuals up to $20,000 and from that amount up by gradations, a progressively increasing tax called an additional tax, is imposed. No tax, however, is levied upon incomes of unmarried individuals amounting to $3,000 or less nor upon incomes of married persons amounting to $4,000 or less. The progressive tax and the exempted amounts, it is said, are based on wealth alone and the tax is therefore repugnant to the due process clause of the Fifth Amendment.

2. The act provides for collecting the tax at the source, that is, makes it the duty of corporations, etc., to retain and pay the sum of the tax on interest due on bonds and mortgages, unless the owner to whom the interest is payable gives a notice that he claims an exemption. This duty cast upon corporations, because of the cost to which they are subjected, is asserted to be repugnant to due process of law as a taking of their property without compensation, and we recapitulate various contentions as to discrimination against corporations and against individ-

uals predicated on provisions of the act dealing with the subject:

(a) Corporations indebted upon coupon and registered bonds are discriminated against, since corporations not so indebted are relieved of any labor or expense involved in deducting and paying the taxes of individuals on the income derived from bonds.

(b) Of the class of corporations indebted as above stated, the law further discriminates against those which have assumed the payment of taxes on their bonds, since although some or all of their bondholders may be exempt from taxation, the corporations have no means of ascertaining such fact, and it would therefore result that taxes would often be paid by such corporations when no taxes were owing by the individuals to the Government.

(c) The law discriminates against owners of corporate bonds in favor of individuals none of whose income is derived from such property, since bondholders are, during the interval between the deducting and the paying of the tax on their bonds, deprived of the use of the money so withheld.

(d) Again corporate bondholders are discriminated against because the law does not release them from payment of taxes on their bonds even after the taxes have been deducted by the corporation, and therefore if after deduction the corporation should fail, the bondholders would be compelled to pay the tax a second time.

(e) Owners of bonds the taxes on which have been assumed by the corporation are discriminated against because the payment of the taxes by the corporation does not relieve the bondholders of their duty to include the income from such bonds in making a return of all income, the result being a double payment of the taxes, labor and expense in applying for a refund, and a deprivation of the use of the sum of the taxes during the interval which elapses before they are refunded.

3. The provision limiting the amount of interest paid which may be deducted from gross income of corporations for the purpose of fixing the taxable income to interest on indebtedness not exceeding one-half the sum of bonded indebtedness and paid-up capital stock, is also charged to be wanting in due process because discriminating between different classes of corporations and individuals.

4. It is urged that want of due process results from the provision allowing individuals to deduct from their gross income dividends paid them by corporations whose incomes are taxed and not giving such right of deduction to corporations.

5. Want of due process is also asserted to result from the fact that the act allows a deduction of $3,000 or $4,000 to those who pay the normal tax, that is, whose incomes are $20,000 or less, and does not allow the deduction to those whose incomes are greater than $20,000; that is, such persons are not allowed for the purpose of the additional or progressive tax a second right to deduct the $3,000 or $4,000 which they have already enjoyed. And a further violation of due process is based on the fact that for the purpose of the additional tax no second right to deduct dividends received from corporations is permitted.

6. In various forms of statement, want of due process, it is moreover insisted, arises from the provisions of the act allowing a deduction for the purpose of ascertaining the taxable income of stated amounts on the ground that the provisions discriminate between married and single people and discriminate between husbands and wives who are living together and those who are not.

7. Discrimination and want of due process results, it is said, from the fact that the owners of houses in which they live are not compelled to estimate the rental value in making up their incomes, while those who are living in rented houses and pay rent are not allowed, in making up their taxable income, to deduct rent which they have

paid, and that want of due process also results from the fact that although family expenses are not as a rule permitted to be deducted from gross, to arrive at taxable, income, farmers are permitted to omit from their income return, certain products of the farm which are susceptible of use by them for sustaining their families during the year.

So far as these numerous and minute, not to say in many respects hypercritical, contentions are based upon an assumed violation of the uniformity clause, their want of legal merit is at once apparent, since it is settled that that clause exacts only a geographical uniformity and there is not a semblance of ground in any of the propositions for assuming that a violation of such uniformity is complained of. *Knowlton* v. *Moore*, 178 U. S. 41; *Patton* v. *Brady*, 184 U. S. 608, 622; *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 158; *Billings* v. *United States*, 232 U. S. 608, 622.

So far as the due process clause of the Fifth Amendment is relied upon, it suffices to say that there is no basis for such reliance since it is equally well settled that such clause is not a limitation upon the taxing power conferred upon Congress by the Constitution; in other words, that the Constitution does not conflict with itself by conferring upon the one hand a taxing power and taking the same power away on the other by the limitations of the due process clause. *Treat* v. *White*, 181 U. S. 264; *Patton* v. *Brady*, 184 U. S. 608; *McCray* v. *United States*, 195 U. S. 27, 61; *Flint* v. *Stone Tracy Co., supra; Billings* v. *United States*, 232 U. S. 261, 282. And no change in the situation here would arise even if it be conceded, as we think it must be, that this doctrine would have no application in a case where although there was a seeming exercise of the taxing power, the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation but a confiscation of property, that is, a taking

of the same in violation of the Fifth Amendment, or, what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality as to inevitably lead to the same conclusion. We say this because none of the propositions relied upon in the remotest degree present such questions. It is true that it is elaborately insisted that although there be no express constitutional provision prohibiting it, the progressive feature of the tax causes it to transcend the conception of all taxation and to be a mere arbitrary abuse of power which must be treated as wanting in due process. But the proposition disregards the fact that in the very early history of the Government a progressive tax was imposed by Congress and that such authority was exerted in some if not all of the various income taxes enacted prior to 1894 to which we have previously adverted. And over and above all this the contention but disregards the further fact that its absolute want of foundation in reason was plainly pointed out in *Knowlton* v. *Moore, supra*, and the right to urge it was necessarily foreclosed by the ruling in that case made. In this situation it is of course superfluous to say that arguments as to the expediency of levying such taxes or of the economic mistake or wrong involved in their imposition are beyond judicial cognizance. Besides this demonstration of the want of merit in the contention based upon the progressive feature of the tax, the error in the others is equally well established either by prior decisions or by the adequate bases for classification which are apparent on the face of the assailed provisions, that is, the distinction between individuals and corporations, the difference between various kinds of corporations, etc., etc. *Knowlton* v. *Moore, supra; Flint* v. *Stone Tracy Co., supra; Billings* v. *United States, supra; National Bank* v. *Commonwealth*, 9 Wall. 353; *National Safe Deposit Co.* v. *Illinois*, 232 U. S. 58, 70. In fact, comprehensively surveying all the contentions

relied upon, aside from the erroneous construction of the Amendment which we have previously disposed of, we cannot escape the conclusion that they all rest upon the mistaken theory that although there be differences between the subjects taxed, to differently tax them transcends the limit of taxation and amounts to a want of due process, and that where a tax levied is believed by one who resists its enforcement to be wanting in wisdom and to operate injustice, from that fact in the nature of things there arises a want of due process of law and a resulting authority in the judiciary to exceed its powers and correct what is assumed to be mistaken or unwise exertions by the legislative authority of its lawful powers, even although there be no semblance of warrant in the Constitution for so doing.

We have not referred to a contention that because certain administrative powers to enforce the act were conferred by the statute upon the Secretary of the Treasury, therefore it was void as unwarrantedly delegating legislative authority, because we think to state the proposition is to answer it. *Field* v. *Clark*, 143 U. S. 649; *Buttfield* v. *Stranahan*, 192 U. S. 470, 496; *Oceanic Steam Navigation Co.* v. *Stranahan*, 214 U. S. 320.

Affirmed.